




# **THE BULGARIAN ECONOMY**

IN THE THIRD QUARTER OF 2002

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REPORT BY  
**THE CENTER  
FOR ECONOMIC  
DEVELOPMENT**



The Center for Economic Development (CED) is a Bulgarian non-governmental research institute in the area of economic policy, established in 1997. Its goal is to support the economic development of Bulgaria through encouragement of public debate on economic issues and development of economic policy options.

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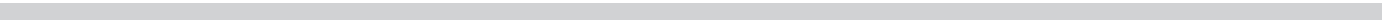
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## ABBREVIATIONS USED

|             |   |
|-------------|---|
| AJB         | ACT ON THE JUDICIARY BRANCH   |
| AMWT        | ASSOCIATION OF MEDICINES WHOLESAL TRADERS   |
| APC         | ACT ON THE PROTECTION OF COMPETITION  |
| ASME        | AGENCY FOR SMAL AND MEDIUM-SIZED ENTERPRISES  |
| ASVPI       | ACT ON SUPPLEMENTARY VOLUNTARY PENSION INSURANCE  |
| ATPSME      | ACT ON THE TRANSFORMATION AND PRIVATIZATION OF<br>STATE-OWNED AND MUNICIPAL ENTERPRISES |
| BAP         | BULGARIAN ASSOCIATION OF PHARMECEUTISTS   |
| BATD (BART) | BULGARIAN ASSOCIATION OF TELECOMMUNICATIONS DEVELOPMENT                                 |
| BCCI        | BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY  |
| BDZ         | BULGARIAN RAILWAYS  |
| BIA         | BULGARIAN INDUSTRIAL ASSOCIATION  |
| BNB         | BULGARIAN NATIONAL BANK   |
| BTC         | BULGARIAN TELECOMMUNICATIONS COMPANY  |
| CITUB       | CONFEDERATION OF INDEPENDENT TRADE UNIONS IN BULGARIA                                   |
| CoM         | COUNCIL OF MINISTERS  |
| CPC         | COMMISSION ON PROTECTION OF COMPETITION   |
| DZI         | STATE INSURANCE INSTITUTE   |
| EC          | EUROPEAN COMMISSION   |
| EIA         | ENVIRONMENTAL IMPACT ASSESSMENT   |
| EU          | EUROPEAN UNION  |
| GDP         | GROSS DOMESTIC PRODUCT  |
| GS          | GOVERNMENT SECURITIES   |
| GVA         | GROSS VALUE ADDED   |
| HPP         | HYDRO-POWER PLANT   |
| IANP        | INTERNATIONAL AGENCY FOR NUCLEAR POWER  |
| ICT         | INFORMATION AND COMMUNICATIONS TECHNOLOGIES   |
| IME         | INSTITUTE FOR MARKET ECONOMY  |
| IMF         | INTERNATIONAL MONETARY FUND   |
| IT          | INFORMATION TECHNOLOGIES  |
| MAF         | MINISTRY OF AGRICULTURE AND FORESTS   |
| MLSP        | MINISTRY OF LABOR AND SOCIAL POLICY   |
| MoE         | MINISTRY OF ECONOMY   |
| MoF         | MINISTRY OF FINANCE   |
| MSSC        | MANDATORY SOCIAL SECURITY CODE  |
| MTC         | MINISTRY OF TRANSPORT AND COMMUNICATIONS  |
| NDSV        | NATIONAL MOVEMENT SIMEON THE SECOND   |
| NEC         | NATIONAL ELECTRIC COMPANY   |
| NFA         | NATIONAL FRAMEWORK AGREEMENT  |
| NHIF        | NATIONAL HEALTH INSURANCE FUND  |
| NRA         | NUCLEAR REGULATION AGENCY   |
| NSI         | NATIONAL STATISTICS INSTITUTE   |
| NSSI        | NATIONAL SOCIAL SECURITY INSTITUTE  |
| PA          | PRIVATIZATION AGENCY  |
| PPCA        | PRIVATIZATION AND POST-PRIVATIZATION CONTROL ACT  |
| SERC        | STATE ENERGY REGULATION COMMISSION  |
| SIC         | SOCIAL INSURANCE CODE   |
| SISA        | STATE INSURANCE SUPERVISION AGENCY  |
| SJC         | SUPREME JUDICIARY COUNCIL   |
| SME         | SMALL AND MEDIUM-SIZED ENTERPRISES  |
| TA          | TELECOMMUCIATIONS ASSOCIATION   |
| TPA         | TRADE PROMOTION AGENCY  |

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*The Bulgarian economy during the third quarter of 2002 confirmed the trend of higher growth. Macroeconomic stability persists. There is certain improvement of indicators such as production and sales in the industry sector, sales in the trade sector, and revenues from the summer tourist season.*

*Nevertheless, apprehensions as to the mid-term prospects of Bulgarian economy persist. Trade balance deficit decreased throughout the quarter under review, however, trade balance remained strongly negative. The volume of foreign direct investments remains unsatisfactory. The pace of privatization slowed down. According to the representative survey of Bulgarian business, the business climate remains neutral (neither good, nor bad) in the third quarter of 2002, but the Estat Index marked a slight drop. Reforms in a number of key areas (healthcare, judiciary, administrative barriers) are in a standstill.*

**Business climate** in Bulgaria is evaluated employing a summarized estimate of the indicator by the representatives of nearly 400 interviewed enterprises. The latest survey was conducted at the end of September. **The Estat Index** integrated estimate obtained as a result of survey data processing is a little lower than that registered for the previous quarter. The value is again within the neutral range of the valuation scale, which interprets the business climate as "neither favorable, nor unfavorable". Despite the negligible change, **the Estat Index** preserves a downward trend in terms of its value. In contrast to the previous period under review, where the decrease was a result of lower optimism about the next quarter, the current lower index value is due to a clearly manifested trend of revaluation of investment attitudes. In the opinion of entrepreneurs conditions for doing business are similar to those in the previous months. Most negative are assessments for the start up of new business, relations with the central administration, inconsistency of legislative initiative, and unfair competition. Criticism was again leveled at the efficiency and unbiasedness of the judiciary, public procurement procedures, the

absence of a well-directed policy to promote the technological and innovative development of companies. In the third quarter assessments are generally more negative compared to the second quarter, but higher compared to the first quarter.

**NSI's general business climate indicator** is at lower levels compared to the previous quarter and slightly above the levels for the third quarter of 2001.

**The general economic dynamics** is improving in the third quarter. GDP's annual growth will be close to the levels for the second quarter and definitely higher than the values for the third quarter of 2001. On these grounds, annual growth is expected to exceed the 4 per cent growth initially set forth in the budgetary macro framework.

Positive expectations are associated with the good monthly indicators of industrial production and trade sales compared to the corresponding months of the previous year. **Industrial production** annual growth is 8.5 per cent for July, 6 per cent for August, and 6.7 per cent for September; net income from sales in the trade sector increased by 6.6, 8.9 и 10.6 per cent, accordingly, with highest growth registered by wholesale trade (by 8.3, 10.9 и 13.5 per cent, accordingly). For the first nine months of the year industrial production increased by 3.9 per cent, and trade - by 2.1 per cent compared to the same period of 2001. **Industry sales** for the first nine months of the year cannot exceed yet the sales for the same period of 2001; however, their annual growth for the third quarter is considerably high (by 7.3, 2.6 и 5.4 per cent by months, accordingly).

The positive economic trends in the third quarter of 2002 are also confirmed by the change in the **confidence index** for the economy, registered by NSI's October monitoring of consumers. Having registered its highest value in July 2001, a sharp decline in October 2001 (and a more smooth decline since January, 2002), in October 2002 the general confidence index for the economy changed its trend.

It registered improvement by 3.7 percentage points compared to July, mainly as a result of the higher values of “confidence in industry” and “consumers’ confidence” indices.

**Inflation** was generally moderate in the third quarter. In July the general level of consumer prices increased, but negligibly - by 0.1 per cent; deflation was again registered in August (-0.7 per cent); it was almost offset by the inflation in September (0.8 per cent) and as a result of accumulated inflation compared to December the increase reached 1.4 per cent, 4.0 per cent compared to September 2001.

In respect of the **labor market**, there is no clear cut trend in the dynamics of number unemployed registered with the Employment Agency. The number of unemployed people decreased from May till September but remains above the level of the 3<sup>rd</sup> quarter of 2001. The increasingly wider gap between registered unemployed and people who have defined themselves as unemployed (in September the latter are by over 60 thousand people more) indicates a need of profound current analysis of the effects of the policies for protection of the unemployed and for promoting legal employment on the labor market. NSI’s data from the Labor Force Monitoring conducted in September 2002 and September 2001 indicate also decreased unemployment by 1.3 percentage points, with decreasing economically active population. The higher number of employed persons - 29 thousand people more compared to September 2001, confirms these data.

Overall, during the first nine months of 2002 a good execution of the revenue part of the **consolidated budget** is observed. As of August 2002, **revenues** amount to BGN 8, 194.7 million, or 66.1 per cent of program revenues, registering an increase of 4.4 per cent compared to the same period of 2001. **Expenditures** amount to BGN 7, 778 million, or 61.4 per cent of program expenditure (an increase of 1.9 per cent compared to August 2001 година). A **surplus** to the amount of BGN 416.7 million was registered.

As of the end of September the total amount of government and government guaranteed debt was BGN 18, 929 million, or 61.5 per cent of GDP (according to updated estimates of the latter by the Ministry of Finance). Compared to the end of second quarter the total amount of debt increased by BGN 74 million, mainly as a result of the appreciated dollar against the EURO, measured at the end of both periods. Total debt/GDP (estimate) ratio registered no change compared to June when its value was 61.3 per cent.

Total amount of **foreign debt** in Brady Bonds (principal plus accrued interest) decreased by USD 68.1 million from the end of June till the end of September 2002 (from USD 3 423.5 m. to USD 3 355.4 million), as a result of July repayments. Total foreign debt decrease from the end of June till the end of September is USD 112.9 million, which is mainly a result of the above fact and exchange rate dynamics. According to end of September estimates, total amount of foreign debt is USD 8 519.4 million, or BGN 16, 899 million at the central USD/BGN exchange rate of BNB.

As of the end of September 2002 total **domestic debt** amounted to BGN 2, 029.6 m. (including government debt of BGN 2, 026.6 m. and internal government guarantees of around BGN 3 m.). The total amount of domestic debt increased by BGN 80.4 m. compared to the end of the second quarter. The third quarter revealed a different yield dynamics of short-term and long-term government securities compared to the second quarter. The yield of three-month bonds decreased, whereas that of long-term bonds increased. The share of government securities issued to finance the budget deficit is increasing compared to the end of second quarter, whereas the share of securities issues for the structural reform is decreasing.

The pace of **privatization** in the state sector remains unsatisfactory in terms of the number of transactions made in the period under review. Eighty-seven transactions were made in the first nine months of the year (61 for shares and interests in whole enterprises



and 26 for detached parts), whereas in the second quarter the transactions were only 19 (10 for whole enterprises and 9 for detached parts). The total financial effect thereof reached USD 217.525 m. (including agreed payments of USD 149.613 m.) As of the end of September 2002 the privatization plan was fulfilled at only 24.9 per cent in terms of the number of transactions and at around 58 per cent in terms of agreed payments, which represents a serious lag. Another trend observed in the third quarter of 2002 is worth noting. A couple of proposals for amendments to the recently adopted Privatization and Post-Privatization Control Act were introduced in the National Assembly. It should be noted that a major criticism towards the repealed TPSMEA concerned the numerous (around 30) amendments in the ten years of its effectiveness, which considerably altered its basic idea, also changing and making even somewhat contradictory its application in practice.

No progress was registered in respect of the policy for **small and medium-sized enterprises**. A tax policy work group was set up at the Consultative Council for Small and Medium-sized Enterprises. The group prepared a package of consolidated proposals and submitted these to the Ministry of Finance for discussion in early September. Despite the efforts of the Interministerial Work Group at ASME on optimization of regulatory procedures to improve the administrative and regulatory environment for doing business, and the terms fixed to take actions along these lines, there has not been noticeable progress so far. Coordination of the different government institutions directly related to the implemented policy in support of the SME sector should be improved, achieving thereby a better efficiency of their actions.

Some positive trends in Bulgaria's **foreign economic relations** were confirmed in the third quarter. Despite the slower pace of recovery of world economy (West-European in the first place) exports registered permanent growth in terms of value and as of year-end they would probably exceed the 1995 level, which was the highest for the last decade. The most pronounced

characteristics of Bulgarian exports is the continuing growth of their EU share - EU countries account for 56 per cent of total export. In the third quarter imports struck a peculiar record (compared to both the first two quarters of 2002 and the third quarter of 2001), but their overall value for the first nine months of the year increased by 2 per cent only compared to the same period of 2001. Imports from EU now exceed 51 per cent, which indicates further Europeization of national trade as a result of Bulgaria's efforts for EU accession. In terms of exports commodity structure, the share of consumer goods registered most rapid growth, accounting now for 35.8 per cent of total exports, whereas the share of prime and raw materials remained the same (41 per cent). Export of investment goods registered considerable growth, accounting for 13 per cent of total exports. With regard to imports, investment goods and prime and raw materials registered the highest growth, which is an evidence of economic activity in the country and expansion of production.

The higher growth rates of exports compared to imports resulted in lower **trade deficit**. Total trade deficit (FOB export/CIF import) for the first nine months of the year reached USD 1384 m., marking a decrease of 7 per cent compared to the same period of 2001.

In the third quarter of 2002 **foreign direct investments** were only USD 70 m., registering the lowest registered quarterly level in the last 4 years. Total volume of attracted foreign investments since the beginning of the year is USD 313.7 m., or 63.5 per cent of investments for the same period of 2001. At the same time national economy registers good growth rates, mainly as a result of the higher investment activity in the industry sector. This growth is a result of both economic restructuring and foreign investments in recent years. Therefore, attracting new foreign investments is of key importance to maintain the growth rate of Bulgarian economy.

Government policy in **the energy sector** was manifested above all in specifying further the conditions



for development of the business. The appointment of a privatization consultant for the seven electricity distribution companies was an important step towards realization of Government's intentions for withdrawal of the State from its ownership functions and conferring the latter on the private sector as a condition for competition, more efficient resource management and improved technological and management level of enterprises in the sector. The draft law on Oil and Oil Product Reserves and the formulated Government and parliamentary position on the future of the small units in Kozloduy NPP allowed to provisionally close Chapter "Energy" of the accession negotiations between Bulgaria and the European Union. It should be noted that this position of the Government and the Parliament was not backed up with convincing economic arguments (which was one of the reasons for the ensuing violent public debate). Higher oil prices at international markets had an adverse effect on both the price terms of energy supplies to the real sector and the costs of power companies. This adverse effect will be partially offset by the lower electricity prices for big consumers since October 2002, and by the lower prices of public lighting and natural gas.

In the third quarter of 2002 **the transport sector** did not witness any development towards substantially improved efficiency of both the sector itself and the benefits its services generate to other sectors. A number of issues, such as permitting private initiative in railway transportation and railway infrastructure maintenance, were not settled in the third quarter. However, some actions like the progress of amendments to the Act on Bulgarian Marine Areas, Inland Waterways and Ports, and the measures taken to improve the financial situation of BDZ (closing loss-generating lines, for example) will have positive effect on the transport sector in the next months. At present losses are accumulated, state aid is granted, and the penetration of private competition is delayed.

A few major themes and events in the area of **high technologies and communications** attracted the attention of experts and the media in the third quarter

of 2002. The draft law on Telecommunications, the completed e-Government strategy, and the new structures within the third sector are the most important. Overall, despite the media clamor, the quarter did not witness any significant progress in the area of high technologies and telecommunications. Discussions on the draft law on Telecommunications were not based on a uniform position of either private sector representatives or lawmakers. Unfortunately there was no clear development of the privatization transaction for BTC in the third quarter, either. Proposals of candidate buyers disappointed most experts, which further complicates the future development of the procedure.

The positive trend in the **tourism** sector persists. In the third quarter of 2002 revenues from tourism reached USD 665.1 m., registering an increase of around USD 75 m. compared to the same period of 2001. As of September, revenues from tourism amounted to USD 1 150.6 m., with USD 1 049.9 m. for the same period of 2001 (an increase of 9.5 per cent). Based on the above data the latest summer tourist season can be assessed as successful. At the same time the higher number of foreign trips of Bulgarian nationals offsets to some extent the positive balance in tourism. The number of Bulgarian tourists who spent their holidays at the Black Sea via Bulgarian tour operators remains low. Problems in the tourist sector are still mostly related to absence of good national advertising campaign, inability to attract and keep Bulgarian tourists in the country, illegal construction in the beach zones, insufficient capacities for entertainment and sports in the resorts.

**Agriculture** will witness a good 2002 crop despite the bad weather in August and September. October rainfalls delayed autumn sowing and 2003 winter wheat areas will be smaller. That could be offset by larger summer wheat areas and a higher corn and sunflower yield. Harmonization of national to European agricultural legislation continued with a view to create conditions to implement support facilities for agricultural producers and develop-

ent of rural regions. Most important are the draft amendments to the Agricultural Producers Support Act whereby the State Agriculture Fund is assigned the functions of an intervention agency. The aim is to encourage agricultural production, to increase its competitiveness in the international markets, and to build stable farms able to apply quality criteria, to carry out technological re-equipment, and satisfy support facilities eligibility requirements. However, these measures are implemented rather disorderly and under the urge of circumstances than according to some sound long-term plan.

Two major positive news dominated the **capital market** in the third quarter. First, a new regulation of trade in compensatory instruments was implemented. Second, the SOFIX index preserved its permanent upward trend. This fact and the higher liquidity of some securities included in the index could be signaling a trend of improving public companies' indicators, improved corporate management, and market adjustment of the prices of Bulgarian securities, which were undervalued for years. Nevertheless, the role of the capital market in Bulgaria's financial sector remains generally insignificant - at the end of September 2002 the total market capitalization of the Bulgarian Stock Exchange - Sofia AD was below 3.5 of the projected GDP for 2002. Liquidity remains low, the market does not encourage adequately good corporate governance practices, and investment alternatives remain limited. Financial intermediation is still provided mostly through the banking sector.

The **banking system** dominates the financial sector in Bulgaria. The condition of banks in Bulgaria continues to be characterized stable, with excellent capital adequacy and liquidity indicators, and at the same time the bank supervision functions well. Foreign participation in the banking system of Bulgaria is predominant in both equity control and assets under management. Generally, the banking system marks increase of assets and deposits, and of current profit in the third quarter. Current profit of the banking system increased in recent months, however, in

September it was still smaller than December and September 2001. Despite the objective indicators of a trend of improvement, lending activity in support of enterprises, including small and medium ones, is still mostly assessed as limited. Overall, the banking system of Bulgaria is stable, but it remains barely efficient and underdeveloped.

In the field of **social security and pension reform**, the proposed new Social Insurance Code, intended to provide uniform regulation of public relations in the area of social security, excluding health insurance, generated a dispute between the Social Ministry and pension insurance companies about investing pension funds' assets, minimum return level requirements, the amount of social security contributions, pension schemes, and pension reserves. The assets of pension funds continuously increase and represent a substantial financial resource, which should be reasonably and efficiently invested in the real sector of Bulgaria or in foreign securities to provide higher return for the insured.

In the third quarter of 2002 **nominal incomes** registered increase both in terms of wages, salaries and entrepreneurship, and in terms of social benefits. Real income also increased compared to the same period of the previous year (with inflation rates taken into account). One should note that in 2001 the sample of monitored households included 6000 households, reduced to 4 200 from the beginning of 2002 till July, and to 3000 households since August 2002. In principle these changes should not have effect on data quality and comparability, however, they should be taken into account for August and September when a more notable increase of the nominal and real income of households was registered. Data from NSI's regular monitoring of household budgets for the third quarter of 2002, and from national representative sociological surveys, reveal a change in the structure of expenses of households in Bulgaria compared to the same period of the previous year. Households spend more money on electricity, telephone, and water bills at the expense of less money for food. On the face of

it, such a trend could be a sign of higher standards of living for Bulgarians, in this case, however, the question is about shrinking food consumption to meet the higher expenses in the other groups.

Topical issues of **industrial relations and social policy** remained in the focus of social dialogue in the summer months traditionally regarded as a period of holidays. That is true first for the expected amendments to the Labor Code proposed by employers' organizations, and for preparations to set up employees' claims guarantee fund in the event of bankruptcy or liquidation of the enterprise.

The **healthcare reform** remains in a standstill, which degenerates healthcare services. Shortage of funds at all levels in the healthcare line and inefficient utilization of funds two years after the start of the healthcare reform are the main reason for the degeneration. The discussions on the progress of the reform in the healthcare sector continued. The proposal to reduce the amount of capital required to license private health insurance companies, which aims at admitting more companies in the private healthcare services market, met the strong resentment of licensed companies. The refusal of the Minister of Healthcare to countersign the annex to the National Framework Agreement (NFA), proposed by the branch organizations and the management of National Health Insurance Fund (NHIF), with a view to finance sufficient number of medical examinations in outpatient specialized treatment and to slightly lower the prices of dentist services, was a sign of absence of adequate political will to successfully implement the healthcare reform. NHIF's draft budget expenditure part for 2003 provoked fiery disputes between government and trade union representatives and NHIF Board members. The increase of healthcare appropriations for the next year; the manner of their allocation among NHIF, the Ministry of Healthcare and municipalities; and efficient utilization of funds are again a matter of political will. Overall, there is no political will to outline specific and decisive further steps in the healthcare reform.

The vigorous public debate regarding the adoption of two acts of key importance to the national **environmental policy** in the third quarter of 2002 placed in a new context the question of the role of government policy for environment protection and for providing incentives for economic subjects to invest in environmental projects. The fiery dispute regarding the presidential veto on the two acts was indicative of the complex process of setting up and formulating the new national environmental policy principles, in which harmonization of national legislation with European law is a process of key importance. According to the data in the last competitiveness report announced by the World Economic Forum in Davos in November 2002, Bulgaria's positions in the sector "Environmental Policy" improve in areas such as harmonization of legislation with international standards, clarity and sustainability of national standards.

Bulgaria continued its active work on implementing the Strategy for Accelerated **Accession Negotiations with EU**. With Chapter 25 "Customs Union", provisionally closed chapters reached twenty one as of the end of September. Later, at the Seventh Session of the Conference on Accession Negotiations in Brussels, negotiations were successfully completed on Chapter 28 "Fiscal Control". In November 2002 EU accepted Bulgarian Government's position and Chapter 14 "Energy" was provisionally closed. General assessment of the negotiation process reveals that 11 of the 12 candidate countries, including Bulgaria, have opened negotiations on all chapters. Bulgaria is in the group of countries such as the Czech Republic, Hungary, Latvia, and Slovakia, that have closed between 21 and 27 chapters. At the end of August 2002 the Government approved and adopted a Pre-accession Economic Program (2002–2005). At the end of July 2002 the Government approved Bulgaria's participation in the Media Plus and Media - Training programs for the period 2000–2005. Bulgaria's participation in another three EU programs in the field of employment and social policy was approved in mid-September 2002.

The development of Bulgarian economy in the third quarter of 2002 was also accompanied by certain changes in **other elements of the business environment**. Following amendments adopted in the spring, new amendments to the Public Procurement Act are envisaged. Government's decision to repeal or ease some licensing procedures, taken earlier this year, was to be followed by specific proposals for amendments to primary and secondary legislation. Unfortunately proposals for real reforms in the field of licensing procedures are not many and actual reduction of the number of procedures is slow. New procedures are introduced under the pretext of being required in the process of harmonization of legislation with that of EU. The problem of licensing procedures is not yet settled radically and systematically - an individual approach is currently applied post factum, analyzing existing procedures and seeking ways to amend them. Another approach in this quarter envisaged development of a draft law on Secondary Legislation and Administrative Procedure on Economic Activity. Draft amendments to the Competition Protection Act were approved in September. Discussion of proposals involved serious debates mostly on the composition of the Commission for Competition of Protection and the appointment of its members. Work on preparation of amendments to the Commercial Code in the sections on bankruptcy and liquidation continued in the third quarter. This is a key measure included in the package for encouraging economic growth, which was proposed by Nikolay Vassilev, Deputy Prime Minister and Minister of the Economy later in October. In September supreme judges attacked before the Constitutional Court the amendments to the Judiciary System Act proposed and passed by the Parliament. This act could delay the reform of the judiciary system. And last but not least, in the middle of the year the Government approved a Strategy for the Modernization of Public Administration with an implementation plan thereof. This is the latest strategy for improving the efficiency of public administration. It is not clear whether this strategy will serve its purpose as it has defects - absence of good structure

and consistency of measures, unclarified aspects of the status of civil servants - hiring, firing, etc.



## The Estat Index of Business Climate

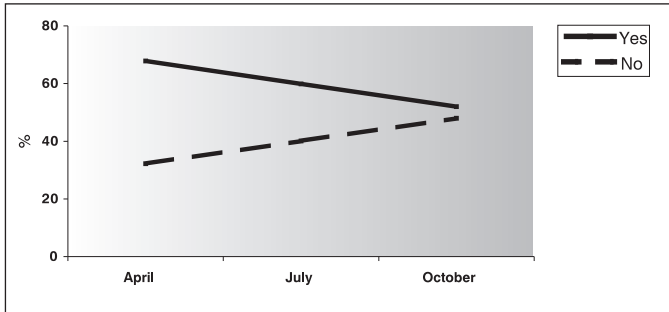
The Estat Index integrated estimate<sup>1</sup> for the period July - September is **-1,84**. The change compared to the previous quarter under review is only 0.28 points [-1.84- (-1.56)]. **According to the valuation scale employed, the variation is interpreted as an insignificant change, and the index value remains within the “neither favorable, nor unfavorable” interval.**

Despite the negligible change, **the Estat Index** preserves a downward trend. Components preserve a downward trend in terms of values. Unlike the previous period under review (April - June), when the lower value was attributed to a seasonal drop in the optimistic expectations for the coming quarter, the current lower index value is due to a clearly manifested trend of revaluation of investment attitudes, i.e. to a change in the second index component “Investment Attitudes and Corporate Strategies”. The share of company managers interviewed, who would borrow from a bank in order to invest (Figure 1) dropped down by 8 per cent, and compared to the period January - April the decrease is almost 16 per cent.

The drop is rather due to an unfavorable assessment of the conditions offered by credit institutions than to unwillingness to develop the core business. Such an assumption is also fed by the fact that no drop is observed in the share of those who agree with the statements related to investment only, such as “If I had available resources, I would invest them in another business, notwithstanding any risk”, or “If I do not have available resources to invest in the core business, I would do my best to ensure them.” There is no difference between July and September with regard to these statements.

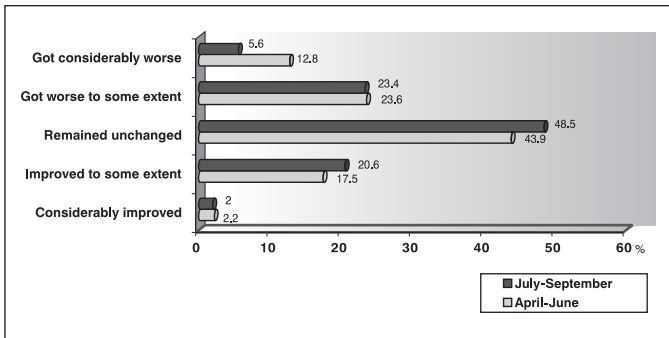
<sup>1</sup> The index methodology and the mathematical model are developed by the **Estat Agency for Social and Market Studies**. The integrated indicator comprises three components. Component I “General Condition of the Company”, Component II “Investment Attitudes and Corporate Strategies”, and Component III “Business Environment”. The survey was conducted between 22<sup>nd</sup> and 30<sup>th</sup> September 2002 and involved 395 companies. The sample is representative at the level of going concerns. Selection criteria for sample companies involve: region, sector, number of employees, and type of ownership. The scale employed to interpret the index is with a range of -100 up to +100 points and is divided in five equal ranges. Ranges thus defined practically exclude transferability from one category to another on the basis of random factors. The first and second **Estat Index** values fell within the -20 +20 range.

Figure 1: I would borrow from a bank in order to invest



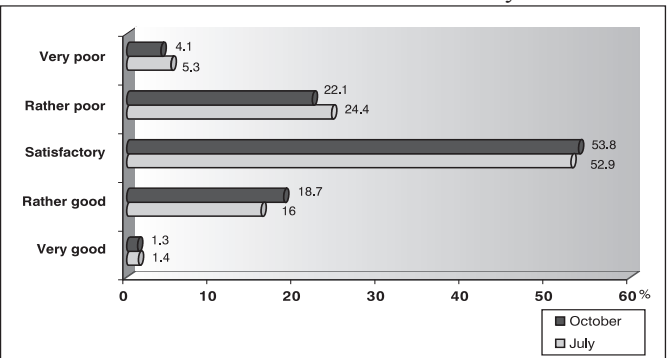
Variations may be insignificant, yet Figure 2 clearly reveals that changes in the assessments of the business about the past are positive – the share of those who state that the conditions of their business changed for the worse decreased, and the share of those who state improvement increased. Neutral estimates remain dominant. Forty eight point five per cent of the interviewed state that the conditions of their business has not changed. In June 44 per cent of company managers were of this opinion.

Figure 2: Has the condition of your business changed?



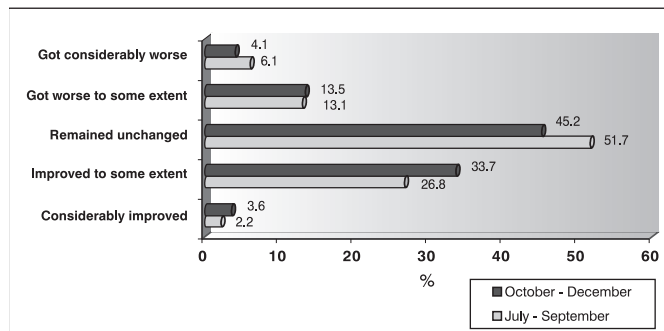
The structure of the change in the assessment of the previous period is also observed in the assessment of the current period and in the forecasts for the next

Figure 3. How do you assess the current condition of your business?



quarter (Figures 3 and 4). There is no change in the estimates of current business conditions. Neutral estimates remain prevailing; over half of the interviewed (53.8 per cent) assess the current state as “satisfactory”.

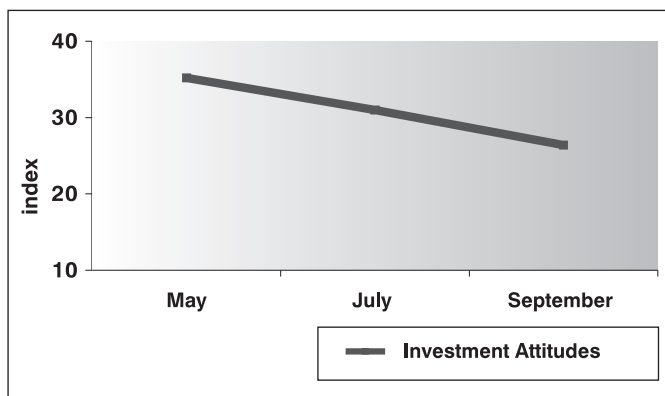
Figure 4: Will the condition of your business change?



Concerning expectations for the future, it is notable that there are changes in the share of optimistic forecasts only. The share of the interviewed who expect their business to change for the worse is considerably smaller than the share of the optimists. On the whole changes are insignificant.

The tendency to invest decreased (Figure 5), although the share of the company managers who experience shortage of liquid resources and the average estimate of financial resources remain unchanged, 68 per cent and 3.36 accordingly (on a scale of 2 to 6).

Figure 5: Component II Dynamics - “Investment Attitudes”



A clear downward trend is observed only for the share of those who intend to borrow from a bank in order to invest. The other statements forming Component II:

Investment Attitudes, of the Estat Index preserve the same or similar values (Table 1).

Table 1. Which of the following statements are true for you?

| Statements about investment attitudes and corporate strategies  | Share of positive answers |       |         |
|---|---------------------------|-------|---------|
|   | April                     | July  | October |
| I continuously control the quality of my products/services  | 96.4%                     | 96.3% | 93.6%   |
| If I do not have resources to invest in my core business, I would do my best to secure them                                   | 89.6%                     | 84.6% | 84.1%   |
| I would introduce new technology if that would increase the quality of products I make, regardless of the effect on my profit | 76.9%                     | 72.1% | 73.9%   |
| I have a business strategy, which I regularly update  | 70.5%                     | 72.9% | 71.6%   |
| I experience shortage of financial resources in my day-to-day operation   | 70.0%                     | 67.0% | 68.1%   |
| I would borrow a bank loan to invest  | 67.8%                     | 59.9% | 52.0%   |
| I have partners on whom my business is dependable in a long-term aspect   | 56.5%                     | 53.8% | 50.6%   |
| I can easily find the workers and employees I need  | 56.4%                     | 60.4% | 51.3%   |
| If I have free resources, I would invest them in some other business, regardless of any risk                                  | 53.6%                     | 51.7% | 51.5%   |
| I prefer to export (I would prefer to export), because I can not realize such profit in Bulgaria                              | 38.2%                     | 35.8% | 35.0%   |

Table 2 clearly reveals the relationship between the size of a company (number of employees) and the tendency to borrow a bank loan. Micro- and small enterprises are most prepared to borrow a bank loan, which is rather a result of government-declared measures in this field than of any business strategy. This conclusion is also supported by the fact that most representatives of big companies, who by default have

more information about the business environment, are not prepared to borrow investment loans.

Table 2. I would borrow from a bank in order to invest / Number of employees in a company

|                                      |     | Number of employees in the company |          |           |          |
|--------------------------------------|-----|------------------------------------|----------|-----------|----------|
|                                      |     | Up to 10                           | 11 to 50 | 51 to 100 | Over 100 |
| I would borrow a bank loan to invest | No  | 48.5%                              | 57.4%    | 57.7%     | 43.8%    |
|                                      | Yes | 51.5%                              | 42.6%    | 42.3%     | 56.3%    |

The tendency to overestimate against competitors one's own capacity and level of development is no longer observed. Table 3 reveals an increase in the share of the managers who think that their company does not have a single advantage over competitors, although average estimates of company resources remain unchanged (Table 4).

Table 3. Competitive Advantages

| Number of competitive advantages | Number of managers giving assessment "better" (%) April | Number of managers giving assessment "better" (%) July | Number of managers giving assessment "better" (%) October |
|----------------------------------|---|--|---|
| NIL                              | 19.5  | 28.3   | 32.5  |
| 1                                | 19.8  | 13.1   | 16.3  |
| 2                                | 18.8  | 24.2   | 17.6  |
| 3                                | 16.5  | 14.4   | 13.9  |
| 4                                | 13.2  | 7.8  | 10.8  |
| 5                                | 7.1   | 6.9  | 3.7   |
| 6                                | 5.1   | 5.3  | 5.2   |

Table 4. Average Estimates of Available Resources in Companies, for July and October

|                                 | Average estimate (July) | Average estimate (October) | No resources (October) |
|---------------------------------|-------------------------|----------------------------|------------------------|
| Agricultural resources          | 3.68                    | 3.88                       | 86.5                   |
| Buildings                       | 4.1                     | 4.15                       | 14.7                   |
| Financial resources             | 3.3                     | 3.36                       | 2.9                    |
| Securities                      | 3.05                    | 3.08                       | 86.6                   |
| Computer equipment and software | 4.06                    | 4.03                       | 30.3                   |
| New technologies                | 3.67                    | 3.73                       | 42.7                   |
| Information resources           | 3.85                    | 4.09                       | 31.2                   |
| Human resources                 | 4.45                    | 4.42                       | 3.1                    |
| Internet                        | 4.57                    | 4.28                       | 42.6                   |

In the third quarter the attitude of the business towards government policy, legislation, tax system, and administration remains critical. For three months the share of those who agree that the Government promotes business development decreased from 17 per cent to 9 per cent.

The study reveals that some companies are exponents of the specific criticism towards the Government and the conditions in Bulgaria. Differences by number of employees are most significant. For example, only one of the 228 interviewed micro-enterprises' managers does not agree that a person works best with the central and the local administration when he knows someone there. Almost 90 per cent of the managers of companies employing 10 to 50 persons agree that changes of legislation are too frequent. All managers of companies with more than 100 employees state that it is difficult to start a new business in Bulgaria.

The above data confirm again that, though aimed at synthesizing a complex integrated index, business climate analysis must also take account of the specifics and problems of different enterprises, regions, and branches.



## Business Environment according to Estat Agency Surveys

The results of the business survey conducted by the Estat Agency in September do not reveal any material changes compared to both the second and the first quarter. Entrepreneurs' assessments of the conditions for doing business are similar to those for the previous months. Business problems, which were outlined as early as April, persist. Most negative are assessments for the start up of new business, relations with the central administration, inconsistency of legislative initiative, and unfair competition. Criticism was again leveled at the efficiency and unbiasedness of the judiciary, public procurement procedures, the absence of a well-directed policy to promote technological and innovative development of companies.

Generally speaking, business circles were most optimistic in the second quarter, i.e. in early summer. On the whole, results for the third quarter are less negative compared to the second one and better than those for the first quarter.

Changes in the attitudes towards the business environment could be given the following comment.

### *Administrative barriers*

Conditions for the start up of new business in Bulgaria remain the indicator given most negative assessments in the survey. The interviewed are almost unanimous - over 90 per cent state that it is definitely difficult to start up new business, which is the level maintained since the first surveys in April. At the same time the number of respondents stating that administrative barriers are definitely the most serious business problem dropped down from 79 per cent in April to 73 per cent in October.

Objective facts reveal that a number of specific steps have been taken, which, though slowly, result in canceling some regimes and alleviating others. Besides, the Government has stated its intention

to formulate the subject matter in specific regulatory documents and adopt uniform rules for introduction of regimes. That will bring about accelerated and more transparent procedures. Consequently, one can expect that the positive trend with regard to this indicator will continue in the future.

### *Institutions and Government*

The share of the entrepreneurs who definitely agree that the Government implements a well-directed business promoting policy remains small (only 9 per cent of the interviewed agree with that). One can expect in this respect that results for the next quarter will be more optimistic, as they could be related to the package of measures to promote economic growth announced in October. Some measures are directed exactly at encouraging entrepreneurship by way of increasingly more reformed and simplified regimes, accelerated bankruptcy procedures, creating free industrial zones, tax concessions in the zones, etc..

The share of the respondents who think that the Government exercises consistent legislative initiative decreased from 17 per cent to 13 per cent. As for the question whether the legislative framework creates equal opportunities for all economic actors, the status quo is preserved at the level of around 17 per cent. Positive change is observed in terms of the application in practice of the regulatory framework; the same is also true for the frequent change of legislation.

### *Relationship with the Central Administration*

The share of the entrepreneurs who agree that government administration is most efficient "when you know somebody there" decreased from 93 per cent to 88 per cent. In principle, such relationship is a precondition for corruption. The share of the managers who are ready to pay some additional money to avoid administrative problems remains generally unchanged at around 79 per cent. However, the corruption environment in the country reveals an upward trend - this fact is reflected in the preliminary papers

on the 2002-2003 Global Competitiveness Report of the World Economic Forum where Bulgaria takes part for a fourth year in succession.

### *Competition in the Domestic Market*

The share of the respondents who believe that unfair competition exists and impedes business remains high, although it decreased from 85 per cent to 82 per cent compared to the previous quarter. Unfair competition remains a problem. It is not clear to what extent envisaged amendments to the Competition Protection Act will manage to overcome this problem. The positive change in this field is questionable, given the contradictions and serious debates on the composition of the Competition Protection Commission during the parliamentary discussions on the act, which suggests that contradictions may be a result of corporate and other private interests and of a desire to influence the work of the Commission.

The percentage of those who firmly believe that public procurement procedures are transparent and clear remains small - around 10 per cent. At the same time the share of those who firmly believe that such procedures are accompanied by corruption and intercession decreased. Amendments to the Public Procurement Act evidently have some positive effect. New amendments that could bring about clearer regulation of these issues and to accelerated and simplified procedures are expected. This could give cause for greater optimism.

### *Tax Environment*

In April 34 per cent of the interviewed fully agreed that the tax system did not create equal conditions for the business, whereas in October the share of the supporters of this view decreased to 24 per cent, which is a sign of an improved opinion about the tax system. On the whole, the attitude towards tax environment remains rather negative. Certain positive conclusions about taxes contained in previous surveys are confirmed – for example, the share of those who assess

patent tax as unbearable decreased from 57 per cent to 55 per cent. The share of the respondents who state that tax rates are high and generate tax evasion decreased compared to April (from 80 per cent in April to 72 per cent in October). The situation with the opinion about social security and health insurance payments is similar - the percentage of the entrepreneurs who think that such payments represent a serious burden on the business decreased from 64 per cent to 61 per cent.

It is notable for all questions about tax environment that in the second quarter the opinion of the business was more positive compared to both the first and the third quarter, which confirms the conclusion made hereabove that in early summer optimism was greater, whereas now positive attitudes seem to decrease.

### *Banking System*

The opinion about the stability of the banking system remains generally unchanged - the latter is assessed as rather stable and reliable - the percentage of the respondents who definitely agree with this assessment remains within the range of 33 - 40 per cent for the three quarters.

### *Policy on Promotion of Innovations and Technological Development*

The policy on promotion of technological and innovative development has been given negative assessment from the start of the surveys. What is more, the share of the entrepreneurs who do not see such a priority outlined in the Government policy increased. In the recent months the Government organized in cooperation with different organizations and institutions forums for discussion of technological and innovative development issues (for example, the international conference on scientific and technical development and cooperation in South-East Europe organized at the end of September, where the scientific and technological development policies of the countries in the region were discussed; an

international conference on Bulgaria's brain draining problems, etc.). Problems are mostly related to the lack of sufficient information and opportunities to promote forum discussions, and to the need of greater awareness of everybody concerned with the issue.

## *European Integration*

Answers to the questions about European integration arouse concern as the share of the entrepreneurs who believe that the harmonization of Bulgarian legislation with that of EU will improve the conditions for doing business in Bulgaria further decreased from 55 per cent in April to 47 per cent in September. This fact confirms again the need to provide more information about the progress of harmonization and the opportunities it offers. Here are some **generalizing conclusions** made on the basis of the three surveys conducted by the Estat Agency in April, June, and September:

- conditions for the start up of new business in the country are given negative assessment;
- entrepreneurs have negative opinion about the transparency and objectivity of public procurement procedures;
- market competition is not sufficiently intensive and fair;
- the policy on technological and innovative development is not a priority;
- the increasingly skeptic attitude of the business towards the benefits and opportunities provided by the European integration process arouses concern.

## Some **positive trends**:

- the assessment of tax environment is more positive;
- there is positive change in the corruption environment;
- the opinion about the application in practice of regulatory documents has improved;
- the banking system is assessed as stable and reliable; there is certain revival in the borrowing activity.

The above conclusions about the opinion of the business can certainly signal the areas and fields where priority measures should be taken.

## **NSI's Business Surveys**

### *General Business Climate Indicator<sup>2</sup>*

In July and August the general business climate indicator decreased by 1 and 3.9 percentage points respectively, mainly as a result of the aggravated business climate in the construction sector. In September, 2002 the general business climate indicator increased by 2.8 percentage points, chiefly as a result of more favorable estimates of the current business situation in the industry and the construction sector. Comparison by quarters reveals that the general business climate indicator is at lower levels compared to the second quarter of this year and negligibly above the levels for the third quarter of last year.

### *Industry*

In the third quarter of the year the composite industrial business climate indicator restored its values and remained at rather higher levels - a leap in July (by 7.4 percentage points), keeping the levels in August, and a slight rise in September (by 1.4 points). The dramatic improvement of industrial business climate in July is mostly associated with the higher export expectations of enterprises. Assessments of current production activity remain at similar levels in July and August, and improve in September.

In the third quarter of 2002 estimates of current production activity in the industry sector are generally higher compared to the same period of last year. On the other hand, procurement of orders in industrial production (measured in number of months) decreased from 4.1 in April to 3.4 in July. The level of orders in

<sup>2</sup> NSI conducts business surveys in accordance with the harmonized EU program. Answers to the questions in the surveys are presented on a three-range category scale of the type: "increase", "no change", "decrease", or "above the normal", "normal", "below the normal". Balances of estimates are calculated as a difference between the relative shares of the extreme variants of an answer. The business climate indicator is a geometrical mean of the balances of estimates for the current business situation and the expected business situation of enterprises in the next 6 months. The general business climate indicator is a weighted arithmetical average of three branch business climate indicators: those of industry, construction, and retail trade.

this quarter generally decreased compared to a year ago. Nevertheless, the rather smoother fluctuations of monthly estimates of order levels (both in the country and from abroad) contribute to a relatively stabilized industrial business climate.

## Construction

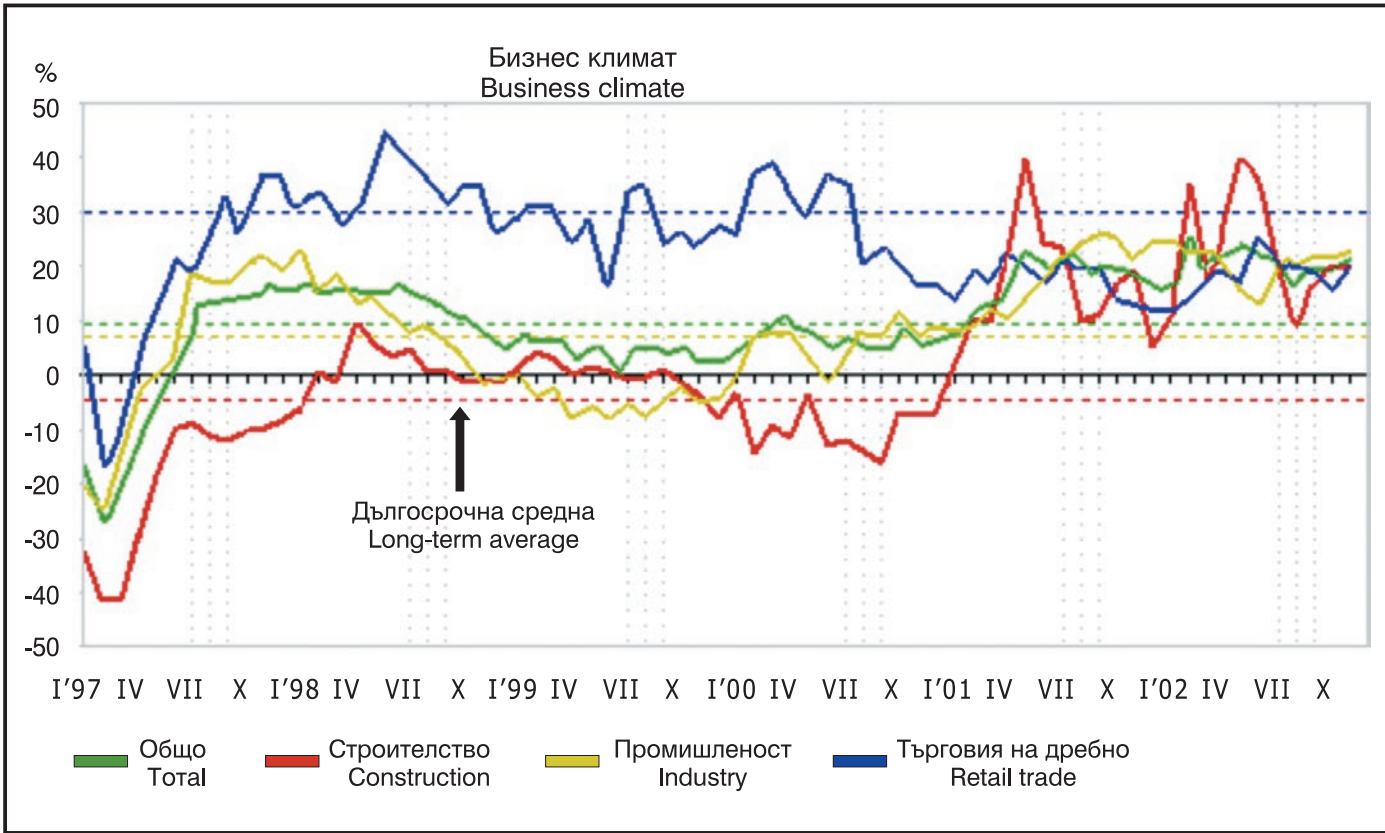
In July business situation, production activity and order level estimates for the construction sector

decrease of the composite “business climate in construction” indicator by another 14.7 percentage points. In September the positive change in the estimates of current business situation improved the business climate in the construction sector - after a dramatic decrease in July and August, the indicator increased by 9.4 percentage points in September.

In the third quarter of 2002 the composite business climate in construction indicator is generally at higher

Figure 6.

Business Climate (NSI)



Source: NSI

remain unchanged compared to a month ago, but the lower expectations about the business situation in the construction sector result in a dramatic decrease of the composite business climate indicator (a decrease of 15.6 percentage points). Estimates of current business situation are more unfavorable in August, moving from “good” to “satisfactory” business condition. In July 37.6 per cent of the enterprises were in a “satisfactory” business condition against 65.8 per cent in August. The main result of this change is a

levels compared to the same period of last year.

## Retail Trade

In July “the business climate in retail trade” lost 3.1 percentage points in value as a result of less optimistic expectations of sales and a slight increase of uncertainty in the economic environment. In August the indicator kept its July level and did not indicate significant change in retail trade situation. In Septem-

ber the business climate in retail trade declined as a result of decreased expectations of sales and orders to suppliers.

In the third quarter the business climate in trade generally remains at the levels for the same period of last year. A longer-range (since April this year) trend of improved estimates of current financial situation of retail trade enterprises is outlined.

#### *Services (Trade Excluded)*

In July the composite “business climate in the services sector” indicator decreased by 1.8 percentage points as a result of slight decline in optimistic expectations of the business situation in the enterprises of this sector. Only healthcare and business services marked increase. Business situation and service demand expectations in the education sector are pessimistic for the coming months.

A further decrease of the composite “business climate in the services sector” was marked in August as a result of lower expectations of the business situation in enterprises for the next 6 months. Expectations are most negative in the transport, hotels, and restaurants sectors. Business climate is more favorable in real estate operations, motor vehicles leasing, machines and equipment, and other public services.

In September the business climate in the services sector improved mainly as a result of higher optimism about the business situation of enterprises in the transport sector (air transport excluded) in the next 6 months.



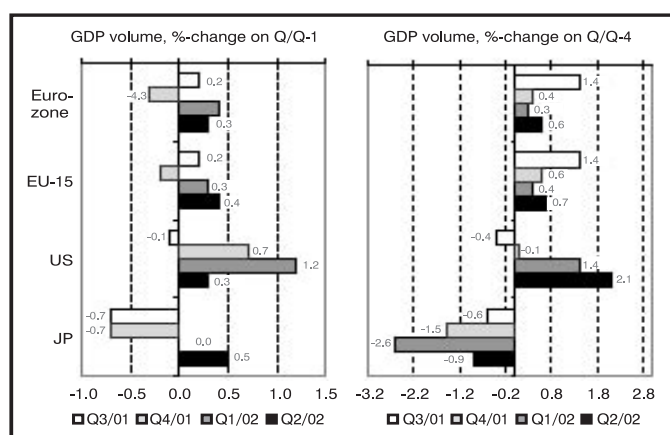
## Gross Domestic Product

Given the high economic growth in the second quarter and the good monthly indicators of industrial production and sales in the trade sector till September, economic growth in the third quarter, taken on an annual basis, is expected to be similar to the growth in the second quarter and definitely higher than the growth in the third quarter of previous year.

GDP in the second quarter of 2002 increased by 5.3 per cent on an annual basis. Owing to this increase, real growth in the first half of the year was 4.3 per cent. In the event of favorable external and internal environment, annual growth is expected to exceed the 4 per cent growth initially set forth in the budgetary macro framework. As of October official growth projections are increased to 4.2 per cent<sup>3</sup>.

Growth in most world economic centers has higher rates on an annual basis - in the second quarter of 2002 GDP growth in the Eurozone is 0.6 per cent (0.3 per cent for the first quarter), in EC-15 - 0.7 per cent (0.4 per cent for the first quarter), in the USA - 2.1 per cent (1.4 per cent in the first quarter), Japanese economy marks subsiding decline (Figure 7).

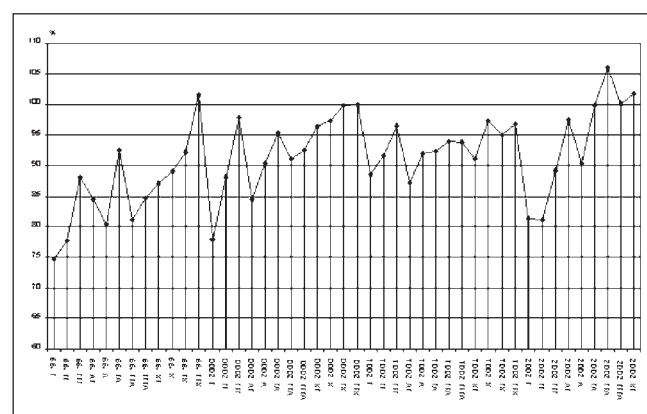
Figure 7. World Economic Growth, Second Quarter of 2002



Source: Eurostat, Statistics in Focus, Theme 2 – 44/2002, QUARTERLY ACCOUNTS - Second Quarter 2002 - Expenditure and Output Approach to GDP - First Eurostat Estimates

In the third quarter monthly indicators of economic activity dynamics in the industry and the trade sectors are good compared to the corresponding months of previous year, and so is the July - September business climate picture by major sectors (according to NSI observations), the two factors causing justified optimistic expectations of general economic growth. (See Annex 1)

Figure 8. Monthly Sale Indices of Industrial Enterprises\*



\* Indices are calculated on the basis of 1997 average monthly sales  
Source: NSI

## Inflation

In the third quarter inflation monthly indicators are generally moderate. In contrast to the second quarter characterized by successive monthly deflation compared to the previous month, in July the general level of consumer prices increased, but negligibly - by 0.1 per cent; deflation was again registered in August (-0.7 per cent); it was almost offset by the inflation in September (0.8 per cent) and as a result of accumulated inflation compared to December the increase reached 1.4 per cent, 4.0 per cent compared to September last year. Compared to last year's average price level, highest increase is registered by the prices of goods and services in the groups: "healthcare" (31.9 per cent, accounting for 5 per cent of households' cash expenses), "alcoholic drinks and tobacco products" (30.8 per cent, accounting for 4.2 per cent of households' cash expenses), and "houses

<sup>3</sup> Source: 2003 State Budget Act Report [http://www.parliament.bg/infocenter/zakonoproekti/Report\\_ZDB2003.rtf](http://www.parliament.bg/infocenter/zakonoproekti/Report_ZDB2003.rtf)

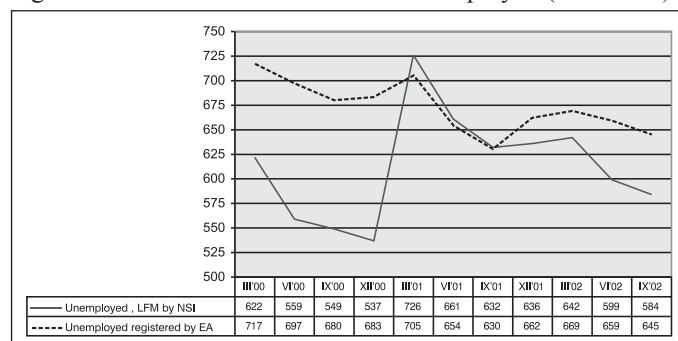
(rent, routine repairs and maintenance), water, electricity, gas and other fuels" (20.2 per cent, accounting for 15.7 per cent of households' cash expenses).

## Labor Market

The trends in the dynamics of number of unemployed registered with the Employment Agency are contradictory - the number of unemployed people decreased from May till September, but remains higher than in the 3<sup>rd</sup> quarter of 2001.

Approximation of the two types of unemployment indicators started in 2001, but at the end of 2001 registered unemployed were significantly prevailing again. This gap continued to increase, exceeding 60 thousand persons as of September this year. (See Figure 9)

Figure 9. Unemployed (thousands)



Compared to September 2001, the number of registered unemployed increased (by almost 15 thousand people), and the number of people who have defined themselves as unemployed decreased (by 48 thousand people). Consequently, the unemployment coefficient of the Employment Agency (in September 2002 it is by 0.4 percentage points higher compared to September 2001) and that under the Labor Force Monitoring (in September 2002 it is by 1.3 percentage points lower compared to September 2001) not only differ numerically, which is explainable, but also seem to indicate reversed trends. The increasingly wider gap between registered unemployed and people who have defined themselves as unemployed indicates a need of profound current analysis of the effects of

the policies for protection of the unemployed and for promoting legal employment on the labor market.

In our opinion, labor force monitoring indicators provide a more reliable picture of labor market dynamics in a macroeconomic context. Comparison between September 2002 and September 2001 outlines some positive even if small changes in the labor market: higher employment, lower unemployment, with decreasing economically active population. The higher employment trend is confirmed by the higher total number of employed persons - by 29 thousand people compared to September 2001; behind this figure are 55 thousand people more employed in the private sector and 26 thousand people less employed in the public sector. (See Annex 1)

Given that the Employment Agency has changed as from July 2002 the basis of computation of the registered unemployment ratio (total for the country and by municipalities), we would like to point out the following. Unemployment level by municipalities is a basis for preferences (under art. 60 (3) of the effective Corporate Income Taxation Act) aiming at promoting employment in regions with high unemployment rates. The incentive for employers investing in municipalities with unemployment rates exceeding by 50 per cent the average rate for the country, is in the form of tax concessions. In the current year concessions are valid for 106 municipalities (explicitly listed in an Annex to art. 60, subsection 3 of the effective act). But where unemployment level by municipalities is recalculated employing March 2001 data about the economically active population, the number of municipalities with unemployment rates exceeding by 50 per cent the average rate for the country increases. The change in the basis of unemployment computation will be probably adequately regulated in the amendments to the Corporate Income Taxation Act.

Generally, the recalculated unemployment coefficient will be considerably higher for municipalities



with high migration and depopulation levels. For example, according to August unemployment data, recalculated unemployment coefficients increase by 16.39 percentage points for the municipality of Madzharovo, by 13.88 percentage points for Boynitsa, by 12.87 percentage points for Samuil, by 11.99 percentage points for Nikola Kozlevo, by 10.59 percentage points for Hayreddin, by 10.23 percentage points for Makresh, and by 10.21 percentage points for Borovo.

Table 5. Labor Force Monitoring (NSI)

|                            | <i>Labor force</i> |                 |                   | <i>Persons not included in the labor force</i> | <i>Economic activity ratio</i>                     | <i>Employment ratio</i> | <i>Unemployment ratio</i> |
|----------------------------|--------------------|-----------------|-------------------|--|--|-------------------------|---------------------------|
|                            | <b>Total</b>       | <b>Employed</b> | <b>Unemployed</b> |  |  |                         |                           |
|                            | <b>Thousands</b>   |                 |                   |  | <b>% (variation is given in percentage points)</b> |                         |                           |
| IX'2001                    | 3406.7             | 2774.3          | 632.4             | 3385.7   | 50.2   | 40.8                    | 18.6                      |
| IX'2002                    | 3388.2             | 2803.7          | 584.5             | 3321.5   | 50.5   | 41.8                    | 17.3                      |
| Variation IX'2002-IX'2001) | -18.5              | +29.4           | -47.9             | -64.2  | +0.3   | +1.8                    | -1.3                      |

Source: NSI

## Budget Execution in the Third Quarter of 2002

*Consolidated Budget (comprising the national budget and the legislature budget)*

Overall, execution of the consolidated budget revenues in the first eight months of 2002 is good and in compliance with the adopted program. **Revenues** by August 2002 accounted for BGN 8,194.7 million, or 66.1 per cent of the program, an increase of 4.4 per cent over the last year's same period. **Expenditures** amounted to BGN 7,778 million, or 61.4 per cent of the program (an increase of 1.9 per cent compared to August 2001). A **surplus** of BGN 416.7 million was reported.

Table 6. Execution of the Consolidated Fiscal Program as of the end of August

| Indicators<br>million BGN | 2001<br>reporting<br>as of 31st<br>August | 2002<br>program | 2002<br>data as of<br>31st August <sup>4</sup> | % of<br>execution<br>against the<br>program |
|---------------------------|---|-----------------|--|---|
| Revenues                  | 7,850.2                                   | 12,406.0        | 8,194.7  | 66.1  |
| Expenditures              | 7,931.5                                   | 12,663.4        | 7,778.0  | 61.4  |
| Deficit/<br>Surplus       | -81.3                                     | - 257.4         | 416.7  |   |

Source: Ministry of Finance

According to the Government Report on the draft State Budget Act of the Republic of Bulgaria for 2003, good execution of the consolidated program is due mainly to lower interest expenses in the national budget rather than higher revenue collection.

*National Budget (comprising the central budget and the budgets of the government agencies)*

As of 31st August, 2002 **the national budget ran a surplus** of BGN 577.9 million against a deficit of BGN 468.8 million for the period by August 2001. **Revenues** amounted to BGN 4,783.1 million, or 68.5 per cent of the projected annual amount, against BGN 4,309.5 million for the same period of last year, or an 11 per cent increase over August 2001. **Expenditures**

accounted for BGN 4,523.5 million, or 60.1 per cent of annual projections, against BGN 4,778.4 million in the last year's same period, an increase of 5.3 per cent over August 2001.

## Municipal Finance

By August **transfers from the national budget** to municipalities accounted for BGN 524.2 million, or 71.9 per cent of projected transfers under the program and an increase of 22.2 per cent on the transfers made in the same period of last year.

At the end of August the government approved distribution of national and local activities for municipalities and the standards for their funding, which may be interpreted as a first step to introducing fiscal decentralization. The idea is to achieve clear allocation of the financial responsibilities of the expenditures for education, health care, social activities and culture. The adopted standards for funding had to be in conformity with the spending ceilings in the draft Budget 2003. Thus, on the basis of income tax revenues remitted by the central government, which will remain in local treasuries, municipalities should be able to meet their expenditures on public activities. It is considered that the majority of municipalities would not need subsidies. According to Kiril Ananiev, Deputy Finance Minister, local expenditures on the activities delegated by the central government total BGN 1, 498 billion. These will be covered by the amount of the remitted income tax and if the latter proves insufficient, funds from the central budget will be allocated.

Fiscal decentralization is a continuous process encompassing the entire system of financial relationships at all levels of public administration. Its main goal is to provide public services in quantity, quality and prices corresponding to the needs and affordability of citizens on the basis of sustainable and long-term balancing of the spending responsibilities of municipalities with stable sources of revenues and effective civil control.

<sup>4</sup> Source: MF - preliminary data on the monthly report of budget credit executor.

Fiscal decentralization shall follow the following principles:

- Establishing a system of incentives to increase local revenues, strengthening of financial management potential and maximum local autonomy in determining the nature and number of municipal services.
- A simplified structure of financial relationships.
- Strict financial discipline by the central and local administrations.
- Possibility for the central government to monitor and assess the process of decentralization.
- Taking account of the differences between municipalities in terms of financial resources, management competences, and the possibilities of different municipalities for development depending on their specific resources.
- Conditions for effective civil control.

The major problem, which should be in the focus of municipal finance reform and local charges and taxes in particular, is the threat of imbalance. It takes two forms - quantity imbalance, between revenues and expenditures, and quality imbalance, between rights and responsibilities. In order to restore equilibrium, measures should be taken to increase revenues and cut expenditures.

### Taxes and Duties

**Tax revenues** in the national budget by August 2002 amounted to BGN 3,500.2 million, or 64.2 per cent of the planned funds (1.5 per cent more than taxes collected in the same period of last year). **Non-tax revenues** totaled BGN 1,281.5 million or 83.7 per cent of the program, an increase of 48.9 per cent over non-tax revenues collected in August 2001.

According to the Customs Agency data, revenues from imported goods from **customs duties, VAT, excise duties and fines, sanctions, and interest** in the national budget (cash execution) tota-

led BGN 268,509,157 in October 2002 against BGN 242,614,674 in the last year's same period (revenues collected in October 2002 exceeded those collected in October 2001 by BGN 25,894,483).

Net revenue in the national budget (cash execution) collected by the customs administration was by BGN 124,880,423 more than the net customs revenue collected in the ten months of 2001. Total customs revenues for the period January – October 2002 were BGN 2,193,687,945 against BGN 2,068,807,522 in the last year's same period.

**The VAT account took effect as of 1st August, 2002** by way of addendum to the Regulation on the Implementation of the Value Added Tax Act. Amendments to the Regulation allow companies to make use of the VAT account, which is mandatory to open but voluntary to use. Till now bona fide taxpayers suffered from the provisions of the Tax Procedure Code envisaging that the tax administration may refuse to refund VAT where a predecessor in the chain has been proven wrong. The period of VAT refunding is reduced to 45 days. In a few months it will be clear whether the VAT-account arrangement will help to curb budget draining through VAT.

In the third quarter **proposals for tax policy changes** were announced, effective as of 1st January, 2003. Some of the most important proposals for changes in individual tax acts are, as follows:

#### *Corporate Income Tax Act*

A tax relief is introduced in the form of 100 per cent remission of the tax on manufacturing companies investing in regions with high unemployment rate. The proposed measure aims at creating prerequisites for promoting investment and job creation in the regions with high unemployment.

Repair expenses will not be regulated for tax purposes. Higher annual depreciation rates by asset group (computers and software, vehicles - automobiles

excluded) are introduced.

The profit tax and the municipal tax are replaced by a 23.5 per cent corporate tax to flow into the national budget. The proposed amendment will facilitate tax administration.

Changes are proposed in the provisions on adjusting the financial result in the taxable profit formation with the switch from National to International Accounting Standards. In this respect the texts on transformation of the financial result for tax purposes are made more precise. On the one hand, the changes are governed by the principle of equal footing in corporate taxation, while guaranteeing budgetary revenues, on the other hand.

#### *Natural Persons Income Tax Act*

The tax scale is changed so that the tax burden on all income groups is reduced, the most sizeable reduction being in the lower income groups. The reduction of the tax burden will be comparatively low for the persons in the middle and the upper sections of the income distribution scale. The highest tax rate of 29 per cent is preserved and the income tax ceiling is reduced from BGN 1,000 to BGN 600.

The following will be excluded from the scope of patent activities:

- Hotels and other accommodation facilities with more than 50 beds.
- Retail outlets with more than 100 sq. m. in net commercial area.
- Catering and entertainment establishments with more than 100 seats.
- Construction and repair services.
- Wholesale warehouses.

The criterion for calculation of the patent tax per sq. m. of gross area per unit is proposed to be abolished. Such an abolition would lead to actual reduction of the patent tax. Proposals envisage changes in the scope of different types of activities described in tabl-

es, reducing the tax on some of them and increasing it on others.

#### *Excise Duty Act*

It is proposed that the excise duty on wine is abolished. The excise duty on alcoholic beverages is increased from BGN 0.035 to BGN 0.05 per degree of alcohol. The excise duty on filter cigarettes is increased. The excise duty on leaded gasoline is increased. Also increased is the excise duty on unleaded gasoline.

The Ministry of Finance proposes VAT exemption of imported equipment for implementation of investment projects, provided that the total value of the project exceeds BGN 10 million. The privilege to get refunded 65 per cent of the tax credit for tour operator services sold abroad should also apply to hotel-keepers without tour operator license.

In the third quarter the company **Crown Agents (CA)** prepared **Report** on the implementation of the Bulgarian customs reform. The report provides a detailed description of its activities after the Initial Report of 12nd April, 2002.

The report contains an updated Plan for program implementation as well as a report on the implemented activities laid down in the program. A review and analysis of the process of revenue collection is made to identify the strengths and weaknesses of the Bulgarian customs systems. The review is based on data presented in the Preliminary Report concerning specific cases of fraud, providing more detailed information on the vulnerability of the customs collection procedures applied.

#### **Foreign and Domestic Debt**

**At the end of September the total government and government guaranteed debt amounted to BGN 18,929 million (recalculated at the BNB central exchange rate of the lev for 30th September, 2002), or 61.5 per cent of the gross domestic**

**product (according to the updated GDP estimates based on Ministry of Finance data). Compared to the end of the second quarter, the total debt has grown by BGN 74 million**, due mainly to the appreciation of the US Dollar against the Euro, measured at the end of the two periods. No actual change has occurred in the total debt to GDP (estimate) ratio compared to June, when the ratio (according to Ministry of Finance data) was 61.3 per cent.

**In USD equivalent terms however, the total government and government guaranteed debt decreased by USD 74 million** between the end of June and the end of September 2002 (from USD 9,616 million to USD 9,543 million according to the central exchange rates of the BNB for the corresponding months). This is attributable to the USD appreciation against the Euro combined with changes in the currency structure of the debt, mainly due to USD repayments on Brady bonds in July and positive net internal financing. As of end June 2002, the USD-denominated debt accounted for 51.86 per cent of the total government and government guaranteed debt, while at the end of September it reached 51.60 per cent. By comparison, the share of the Euro-denominated debt dropped from 27.25 percent of the total debt as of end June to 27.20 per cent at the end of September (the share of the BGN-denominated debt in the debt structure increased from 6.94 per cent at the end of June to 7.32 per cent at the end of September, 2002).

In the last quarter of the year debt amount will depend mostly on the dynamics of the Euro/USD exchange rate and the change in the currency structure of the debt. Ultimately, the ratio of the total debt to GDP (estimate) is of key importance and is expected to improve toward successful implementation of the Maastricht criteria.

#### *Foreign Debt*

**Bulgaria's new active foreign debt management policy** was first manifested in the buyback of foreign debt Brady bonds and the placement in November

2001 of Eurobonds with a nominal value of EUR 250 million. Later, in March 2002 the first large-scale operation for replacing foreign debt Brady bonds with new global Eurobonds was effected. This reflected on the foreign debt dynamics in the second quarter of 2002. As of end of June, according to the Ministry of Finance data, the debt in Eurobonds (denominated in Euro and USD) totaled USD 1,594.3 million and the foreign debt in Brady bonds amounted to USD 3,424 million.

The third quarter of 2002 provided latest **evidence of the new active policy on current management of the foreign debt**. In September the foreign debt was restructured again and the Brady bonds were replaced with USD-denominated Eurobonds (through opening the existing March issue which matures in 2015). Summary results of the Ministry of Finance at the end of the third quarter show that Brady bonds of USD 866 million were replaced against issued USD-denominated bonds of USD 759 million. Official data point to a gross reduction of the foreign debt by USD 107 million and lifted collateral of some USD 135 million. Thus, the net reduction of the debt as a result of the September operation amounted to some USD 242 million, according to the Ministry of Finance data.

The operation in question did not reflect on the debt dynamics by the end of the third quarter of 2002. In the period June – September the foreign debt in Brady bonds (principal and accumulated interest) decreased by USD 68.1 million (from USD 3,423.5 million to USD 3,355.4 million) due to the July repayments. As a result of this fact and exchange rate fluctuations **in the period end of June - end of September the total amount of the foreign debt decreased by USD 112.9 million. According to end of September preliminary data, the total foreign debt amounted to USD 8,519.4 million, or BGN 16,899 million**, calculated at the BNB central BGN/USD exchange rate for 30th September 2002 (including USD 7,967.3 million government debt and USD 552.1 million government guaranteed debt).



Data on the last month are provisional. For the purpose of comparability with previous periods the above data on the foreign debt are based on information from the Ministry of Finance while trade credits are not included in the gross foreign debt statistics (in accordance with the new BNB methodology).

In spite of the repeatedly announced goal for improving the foreign debt to GDP ratio (due to the structure of the Bulgarian government debt this ratio is of key importance for compliance with the Maastricht criteria), there are **no indications yet that a long-term strategy for Bulgaria's foreign debt management is in place or is being prepared**. However, the Government Debt Act (presented below), adopted in the third quarter of the year, could be viewed as a necessary step toward such strategy.

### *Domestic Debt*

**As of the end of September the total domestic debt amounted to BGN 2,029.6 million (including BGN 2,026.6 million government debt and some BGN 3 million domestic government guarantees). Compared with the end of the second quarter of 2002, the total domestic debt has increased by BGN 80.4 million.**

As of 30th September the share of the debt on government securities issued for budget deficit financing accounted for 66.55 per cent of the total domestic debt amount (against 65.08 per cent at the end of the second quarter). As of the end of September the share of the debt on government securities issued for the structural reform was 33.3 per cent (against 34.72 per cent at the end of June) of the total domestic debt amount. Domestic government guarantees accounted for 0.15 per cent of the total domestic debt as of the end of September (against 0.20 per cent in the second quarter of the year). Table 7 illustrates the dynamics of the structure of the total domestic debt.

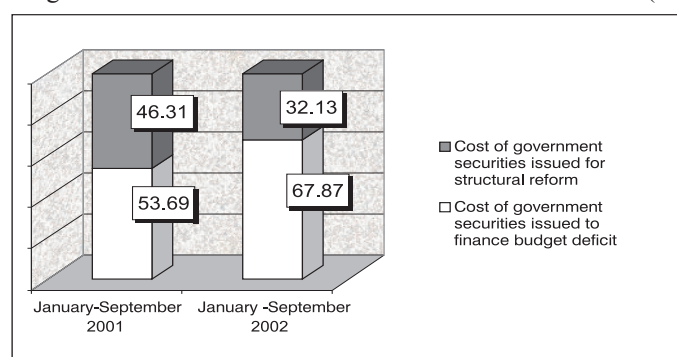
Table 7. Structure of Total Domestic Debt (%)

| Debt structure   | End of September 2001 | End of June 2002 | End of September 2002 |
|--|-----------------------|------------------|-----------------------|
| Debt on government securities issued to finance the budget deficit | 56.4                  | 65.08            | 66.55                 |
| Debt on government securities issued for the structural reform     | 43.17                 | 34.72            | 33.3                  |
| Internal government guarantees                                     | 0.42                  | 0.20             | 0.15                  |

Source: MF data, Government Debt monthly bulletin

Total domestic debt expenditures (interest and discount) for the first nine months of 2002 amounted to BGN 87.6 million (against BGN 108.5 million in the same period of last year, excluding expenditures on the direct debt to the BNB reported by March 2001). Within expenditures, the share of expenditures on government securities issued to finance the budget deficit accounted for 67.87 per cent (against 53.69 per cent of the total domestic debt expenditures, excluding direct debt to the BNB for the first nine months of 2001) and the share of expenditures on government securities issued for the structural reform was 32.13 per cent (against 46.31 per cent of the total domestic debt expenditures). Figure 10 illustrates the dynamics of the domestic debt cost structure in the first nine months of 2001 and 2002, respectively.

Figure 10. Domestic Debt Cost Structure (%)



Source: MF data, Government Debt monthly bulletins

Between July and September 2002 the average annual yield attained in the primary market on the

newly issued government securities for budget deficit financing was 3.74 per cent on an annual basis for three-month bills (three auctions for the period), 5.36 per cent on an annual basis for twelve-month treasury bills (one auction for the period), 6.25 per cent for three-year treasury bonds (two auctions for the period), 6.71 per cent for five-year bonds (two auctions for the period), 7.49 per cent for seven-year bonds (two auctions for the period) and 8.44 per cent for ten-year bonds (one auction for the period), according to BNB data (from the Government Securities Market bulletin of the Fiscal Services Department).

Thus, in respect of the domestic debt **the third quarter reveals different dynamics of the yield on both short-term and long-term government securities compared to the second quarter - yield on three-month securities fell and yield on long-term ones rose. Compared to the second quarter, the share of securities issued for budget deficit financing has increased, while the share of securities issued for the structural reform has declined. Compared to the first nine months of 2001, the share of expenditures on government securities issued for budget deficit financing has increased, while the share of expenditures on securities issued for the structural reform has declined.** This is a direct result of the changed domestic debt structure.

**In the short-term the basic trends of the recent months might persist** – higher yield on long-term government securities issued to finance the budget deficit and gradual extension of the average maturity of outstanding issues calculated on the basis of the maturity structure of respective issues.

**Domestic debt dynamics already suggests an active domestic debt management policy, similar to the discussed new foreign debt management policy.** However, the more vigorous behavior of the Ministry of Finance at the beginning of 2002 resulted in some surprises and necessitated new behavior on the part of many participants on the domestic money market. **Again it is not clear yet whether this is**

**part of a long-term debt management strategy.**

**The actions of the Ministry of Finance and the absence of a debt strategy have come to be considered not only in terms of the purely technical effect but also in the more general context of state governance efficiency.** At the end of June a comprehensive critical report of the National Audit Office was publicized, concerning the audit conducted at the Finance Ministry on domestic government debt origin and management and the use of debt instruments in 2001.

**The recommendations of the National Audit Office** moved along three lines but only the last one saw specific development at the end of the third quarter. In the first place, a new unit should be set up within the Ministry of Finance to take special care of domestic debt management. In the second place, the report of the National Audit Office states that the ministry administration must determine more precisely the maturity of the newly issued securities with a view to smoother distribution of the burden of domestic debt servicing across the years to come. Finally, the National Audit Office insisted on adoption of a Government Debt Act.

**The draft of the Government Debt Act** was presented to the National Assembly as early as January but was finally adopted in September 2002. The Act could be evaluated as positive. It not only systematizes diverse acts but also introduces the long-needed legal norms such as definition of government debt, annual setting of limits on debt growth, an official government debt register, the obligation for the municipalities to notify in advance the Ministry of Finance on debt issue, additional regulation of the BNB fiscal agency, to name but a few. As stated in the motives of the presenters of the draft, one of the more general objectives of the Act is to reduce the cost of budget financing.



**The pace of privatization in the state sector remains unsatisfactory** in terms of the number of transactions made in the period under review. Eighty seven<sup>5</sup> transaction were made in the first nine months of the year (61 for shares in whole enterprises and 26 for detached parts). The transactions signed in the second quarter are only 19 (10 concerning whole enterprises and 9 for detached parts). The total financial effect thereof reached USD 217.525 million<sup>6</sup> (including agreed payments of USD 149.613 million), with contribution of the last 19 transactions amounting to USD 102.054 million. **Privatization Program fulfillment lags behind again. As of the end of September 2002, the privatization plan was fulfilled at only 24.9 per cent in terms of the number of transactions, and at around 58 per cent in terms of agreed payments. Transactions with foreign investors were not signed in the third quarter<sup>7</sup>.**

Different progress is achieved in the privatization procedures for the **expected big transactions - those for BTC, DZI, and Bulgartabac**. The transaction for 80 per cent of the shares in DZI was signed with Contract Sofia OOD (at a price of EUR 21,522,583), with the buyer undertaking to keep unchanged the company's scope of business in the next 5 years, to make investments at the amount of BGL 13 382 000, and to keep the number of jobs for the same period. Thus the whole insurance sector is already private. The competition for Bulgartabac came to its final phase. The Privatization Agency has appointed the successful candidate-buyer among four - the Tobacco Capital Partners-Clar Inis B.V. Consortium. The other three candidate-buyers filed appealed the appointment before the Supreme Administrative Court and the immediate execution was terminated until the case is determined. Practice has proven more than once that in any privatization procedure there is no use to comment details of offers before the transaction is actually finalized, because only the obligations set forth in the privatization contract are real. Two candidate-buyers filed final offers for

the privatization of 65 per cent of the shares in BTC within the stipulated time limit - the Koc Holding-Turk Telecom Consortium, and Viva Ventures Holding.

Table 8. Comparison of Offers by BTC Candidate-buyers

| Candidate-buyer          | For 65 per cent of capital | Increase of capital | Investments     | Jobs in three years |
|--------------------------|----------------------------|---------------------|-----------------|---------------------|
| Viva Ventures            | EUR 200 million            | EUR 50 million      | EUR 400 million | 16 000              |
| Koc Holding Turk Telecom | EUR 185 million            | EUR 50 million      | EUR 400 million | 20 530              |

By a decision dated 1st October 2002, the Privatization Agency's Executive Board requested further explanations to the offers of the two candidate-buyers. The Privatization Agency appointed Viva Ventures Holding the successful candidate, but the work on finalization of the transaction was again blocked due to a determination of the Prosecutor's office that investigates signals on legal violations of the procedure.

**The development and adoption of the secondary legislation** on the application of the Privatization and Post-Privatization Control Act continues. The Privatization Agency's Rules of Procedure which regulate its functions, organization, and structure, were adopted in July. Regulations on the Terms and Procedure for Organization of Centralized Public Auctions for Sale of State-Held Shares were adopted in September. An annual list of commercial companies with state interest in their capital, for which privatization against payment by non-cash instruments is allowed for the year 2002 was approved by Decision No. 485 dated 15th July, 2002, of CoM. The list contains a total of 1073 companies and the corresponding portion of their capital for which such payment is allowed. Later the Privatization Agency defined by its Decision No. 2107-П of 24th September, 2002, a privatization method - public offering - for 85 companies on the list. Regulations were also adopted in September on the mandatory information provided to persons, who have stated their interest to participate in privatization under the Privatization and Post-Privatization Control

<sup>5</sup>Source: PA data, [http://www.priv.government.bg/ap/bg/06/062/pic/4GRTRANSall\\_b2\\_2\\_2002.jpg](http://www.priv.government.bg/ap/bg/06/062/pic/4GRTRANSall_b2_2_2002.jpg)

<sup>6</sup>Source: PA data, [http://www.priv.government.bg/ap/bg/06/062/pic/1AP\\_plast\\_b93\\_2002\\_1.jpg](http://www.priv.government.bg/ap/bg/06/062/pic/1AP_plast_b93_2002_1.jpg)

<sup>7</sup>Source: PA data, <http://www.priv.government.bg/ap/bg/06/063/pic/5schiB.html>

Act, and on documents and information representing official secret. These regulate the type and the volume of mandatory information to be provided to the persons, who have stated their interest to participate in privatization under the Privatization and Post-Privatization Control Act (PPCA), and the terms and procedure of providing such information. The documents and the information related to preparation and carrying out of privatization transactions, which represent official secret, are defined, and the terms and procedure of providing such documents in the event of privatization under PPCA are regulated. By way of an addendum to the list annexed to PPCA, Plovdivski Panair EAD (Plovdiv Fair) was included in the group of companies, for which decision for privatization is taken by the National Assembly, until a strategy on its development and privatization is adopted.

Another trend observed in the third quarter of 2002 is worth noting. A couple of proposals for **amendments to the recently adopted Privatization and Post-Privatization Control Act** have been introduced in the National Assembly. One was even passed and became effective (for placing Plovdivski Panair EAD on the list annexed to PPCA). Proposals are generally along the following lines:

- providing sources to cover the expenses of the Privatization Agency with a portion of the funds for deferred payments under transactions;
- taking the banks out of the regulatory scope PPCA (an expected amendment related to the privatization of DSK Bank, which, like with the other banks, should be carried out by the Bank Consolidation Company, and not by the Privatization Agency);
- eliminating the limitation concerning the annual character of the list of commercial companies with state interest in their capital, for which privatization against payment by non-cash instruments is allowed, and including a possibility for supplementing the list, which would reduce administrative problems related to the annual preparation and approval of such list;
- eliminating the requirement that the Minister of Finance should also (apart from the privatization authority) approve the assessments of companies with rights on the territory of another state, with the argument that it leads to unnecessary delay of the process;
- introducing a new privatization method - assigning of management, with a buy out clause, in the event of at least two unsuccessful attempts to privatize the capital of a company by other methods (such option was provided under Art. 34 of the repealed Transformation and Privatization of State-Owned and Municipal Enterprises Act; however it was not applied in practice in the previous years despite its sound economic meaning);
- explicit regulation of the authority (the Council of Ministers) responsible for the procedure of organization of public and centralized public tenders, competitions, and management with a buy-out clause;
- an opportunity to also make payment by non-cash payment instruments under transactions signed before PPCA came into effect;
- an opportunity for cash proceeds (or a portion thereof) from the sale of shares in other companies of companies with 100% state participation to remain property of the company, where there is a corresponding decision by the competent authorities;
- the procedure of finalizing transactions with pending litigation or effective decisions under the repealed ATPSME (concerning the "negotiations with potential buyers" method which is not included in the new PPCA);
- the concession assignment procedure for privatized companies or detached parts to which concession is not yet granted;
- amending the validity of investment vouchers from 30th September, 2002, to 30th June, 2003 (an amendment also expected, given that the regulation of the procedure for using investment vouchers already issued is delayed and the current validity has already expired);

- placing new companies on the list annexed to PPCA (the interesting point here is the wording “small HPPs”, which are excluded from the requirements for approval by the National Assembly valid for NEC EAD, Sofia, because there is no effective legal definition of this term; if the wording is preserved, there is a risk of blocking the privatization of all HPPs for formal reasons).

It should be noted that a major criticism towards the repealed TPSMEA concerned the numerous (over 30) amendments in the ten years of its effectiveness, which considerably altered its basic idea, also changing and making even somewhat contradictory its application in practice. The first amendment to the new PPCA came only six months after the act was passed. Therefore, it would be advisable to discuss and possibly pass together the amendments proposed, thereby avoiding the previous mistake of numerous “patches” on the text of the old act.

**The newly set up Agency for Post-Privatization Control has not started yet real work**, although its Supervisory Board has been elected. Adoption of Agency’s by-laws continues, as well as its real-time introduction in the bulky work it has to do.

There are no significant events in the sector of small and medium-sized enterprises worth noting during the 3rd quarter.

In August the Consultative Council for Small and Medium-sized Enterprises, set up with the President of the Agency for Small and Medium-sized Enterprises, held its latest meeting attended by Mr. Al Djeburi, Deputy Minister of Finance. The 2003 - 2005 Government tax policy was discussed, as well as some specific tax-related issues of the small and medium-sized business. A Tax Policy Task Force was set up at the Consultative Council. It developed a package of consolidated proposals and submitted these to the Ministry of Finance for discussion in early September. **No particular efforts to formulate and implement a well-directed tax policy in support of the SME sector have been made so far**, but the fact that the initiative for efficient dialogue on the subject with representatives of SMEs and non-government organizations was finally taken is positive.

Despite the efforts of the **Interministerial Task Force at ASME on optimization of regulatory procedures** to improve the administrative and regulatory environment for doing business, and the terms fixed to take actions along these lines, there has not been noticeable progress so far. The only positive development in this field is the wider application of the **"information desk"** approach in the work of municipal administrations.

**Coordination of the different government institutions** directly related to the implemented policy in support of the SME sector should be improved, achieving thereby a better efficiency of their actions. This applies first to the closer cooperation of the Ministry of the Economy and ASME. The status of ASME, its powers and terms of reference, as well as the Government's intentions about its future activity should also be clearly defined. Any ideas about its restructuring or merger with other government structures are not logically justifiable. Furthermore, this creates undue uncertainty in ASME's actions and

prestige in the relationship with other organizations and real business.

The idea about a **National Conference on SMEs** to be organized by ASME may contribute to better systematize at national level current problems encountered by entrepreneurs, to discuss measures to conquer such problems, and to improve in the long run the efficiency of cooperation between the administration and real business and non-government sector representatives.

A **Bulgarian-Japanese forum on industrial policy** was organized in the reviewed period. The results of the completed three-year project on formulating basic guidelines for the development of Bulgarian industry, financed by the Japanese International Cooperation Agency (JICA), were presented at the forum. Promoting the development of SMEs was a major aspect of the project. Special emphasis was laid on the considerable expert support provided by Japanese consultants in developing the National Strategy, the different options for SME guarantee schemes, and in defining measures to improve the efficiency of these businesses. Other forms of cooperation included training of Bulgarian experts in Japan and providing technological equipment for ASME.



## Foreign Economic Relations

Despite the slower pace of recovery of world economy (West-European in particular), **in the second and third quarters of the year exports registered higher growth compared to the same period of 2001.** In the third quarter total exports increased by 14.5 per cent compared to the same period of 2001, and for the first nine months of 2002 they increased by 5.3 per cent. In the first nine months of the year total commodity exports amounted to USD 4 045 m. In a further adjustment the value could be even higher (USD 4 100 – 4 150 m.), which means that by the end of the year exports could reach and exceed the 1995 level, which was the highest for the last decade (USD 5.3 billion).

**Slack demand on the EU-domestic market had almost negligible effect on Bulgarian exports to the European countries.** Exports registered a peak in June, July, and August. Consequently, **in the third quarter of 2002 they increased by nearly 10 per cent compared to the second quarter, and by 9.4 per cent compared to the same period of 2001.** This fact supports the stable upward trend of the EU share in Bulgarian exports. EU trade partners account now for 56 per cent of total exports. The downward trend of Bulgarian exports to CIS countries persists. Exports to these countries are only 4.5 per cent of total exports (5.8 per cent in 2001), whereas in all other groups of trade partners they registered an increase compared to 2001.

**In terms of exports commodity structure, consumer goods registered highest growth in the third quarter of 2002** – by nearly 20 per cent compared to the second quarter, followed by prime and raw materials, which increased by 11 per cent. Export of investment goods continued to grow but at lower rates - by 6.4 per cent. All three groups registered increase between 16 and 20 per cent compared to the third quarter of 2001. Thus, investment goods accounted for 13 per cent of total exports in the first nine months of 2002, prime and raw materials accounted for 13 per cent, and consumer goods - for 35.8 per cent.

In the same period of 2001 these three basic groups accounted for 12, 41, and 33 per cent of total export, respectively.

In the third quarter imports registered a peculiar record (compared to both the first two quarters of 2002 and the third quarter of 2001), but generally they increased by only 2 per cent in terms of value compared to the same period of 2001. The highest increase was registered in July - by 18 per cent compared to the same period of 2001, which is above the July 2001 level (another peak month for imports). In August and September imports restored their usual levels, **but in the third quarter of 2002 imports registered an increase of 6.3 per cent compared to the same period of 2001. In the first nine months of 2002 imports (CIF) amounted to USD 5427 million** (according to estimates), and if they preserve their growth rate, total imports for the year would not be much above the 2001 value (USD 7.2 billion).

Imports from EU registered the highest increase in July - by 25.3 per cent compared to June. Thus, in the third quarter of 2002 imported goods from EU registered an increase by nearly 5 per cent compared to the second quarter, and by 13.7 per cent compared to the same period of 2001. In the first nine months of 2002 the share of imports from EU reached 51.3 per cent, which indicates further Europeization of the country as a result of its efforts for EU accession. Imports from CIS countries (mainly Russia) marked considerable decrease - by 60 per cent compared to the second quarter of 2002, and by half compared to the same period of 2001. Thus, the share of these countries in Bulgaria's total imports dropped below 20 per cent. Imports from Turkey preserve an upward trend - their share already amounts to 4.8 per cent.

**In terms of imports commodity structure, investment goods registered the highest increase in the third quarter of 2002** – by 12.4 per cent compared to the second quarter and by 5.7 per cent compared to the same period of 2001. Similar is the trend with the import of prime and raw materials which increased

by 3.8 and 10.7 per cent, respectively. This is an evidence of economic activity and expansion of production in the country. It can be stated that the growth in the import of consumer goods observed since the beginning of the year is conquered, because in the third quarter imported goods did not exceed the level of the second quarter. However, increase compared to the third quarter of 2001 remains significant - by 18.7 per cent. All that results in change of shares - investment goods account now for one fourth of total imports, and consumer goods - for 19 per cent. The share of prime and raw materials in total imports remains more or less stable – around 35 per cent, whereas the share of energy resources dropped down to 20 per cent.

**The higher growth rates of exports compared to imports resulted in lower trade balance deficit. The deficit registered in the third quarter of 2002 was 78 per cent of that for the same period of 2001, and for the first nine months of 2002 - 90 per cent of that for the same period of 2001.** Total trade balance deficit (FOB export/CIF import) for the period July - September reached USD 459.2 m., and for the first nine months of the year - USD 1384 m. Taking into account the increase of exports observed in recent months, a further adjustment could reveal a lower deficit. If the exports and imports preserve upward trends, annual deficit will amount to around USD 1.9 m., which is a rather good level.

### Foreign Investments

**In the third quarter of 2002 direct foreign investments made in the country amounted to only USD 70 million, registering the lowest quarterly level in the last 4 years.** They decreased by 44 per cent compared to the second quarter of 2002, and by 38 per cent compared to the third quarter of 2001. At the same time, in the first eight months of 2002 investments in equity increased by 15 per cent, and reinvested profit - by nearly 6 times, compared to the previous year. The difference is a result of the negative net amount of internal company loans, i.e. repayment of

the liabilities of companies with foreign participation towards foreign direct investors under financial, bonded, and commercial loans. Total attracted foreign investments since the beginning of the year amount to only USD 313.7 m., or 63.5 per cent of attracted investments for the same period of 2001. Given the absence of big privatization transactions which are usually used to rank investor countries, continuous change of ranking is observed - in the period January - August 2002 the Czech Republic was ranked first with 22.5 per cent of total foreign investments, displacing Greece, Austria, and Germany. Given the current rather slow growth of world economy and the observed decline of investment flows, as well as the delayed big privatization transactions, any material changes in the volume of foreign investments before the end of the year are most unlikely.

## Government Policy

**In the third quarter of 2002 the government policy in the energy sector found its expression most of all in specifying further the conditions for development of the business.**

Two steps during the period under review will have material effect on the progress of negotiations between Bulgaria and the European Union on Chapter "Energy". First, **the draft law on Mandatory Oil and Oil Product Reserves** was introduced in Parliament. The need to regulate such reserves is determined by the EU requirement that all member-states should have quantities of oil and oil products equal to their 90-day consumption, with a view to avoid problems in the event of possible difficulties with supplies. The absence of a legal framework for oil and oil product reserves was subject to negative assessments in the regular reports of the Commission on the progress of Bulgaria.

The draft of CoM states the procedure and method of creating, storing, using, and rebuilding the mandatory stocks of oil and oil products in the country. The plan is to assign the control of this activity to the State Agency for Government Reserve and War-Time Stocks. The draft law introduces a model of shared responsibilities and financing of stock building and maintenance between the State and the business. It envisages additional obligations for the producers and importers of oil and oil products, which certainly has a negative effect on the business environment in the sector. The basic additional obligation is to finance the oil and oil product stock, which means that the business must block financial resources. According to calculations by the Ministry of the Economy, the annual costs to the business for implementing the provisions of the law amount to around BGN 160 million<sup>8</sup>. Given that costs will be finally transferred to end users by way of price, one can expect that the passing and implementation of the act will result in

higher oil and oil product prices.

According to the bill, stocks should reach the 90-day consumption level within nine years, which means that Bulgaria will request during negotiations with the European Union transitional arrangements in this field.

The second step that will influence the progress of negotiations with the European Union is **the formulated Bulgarian Government's position on the destiny of the small units of Kozloduy Nuclear Power Plant (NPP)**. The Government decided to close down the first two units by the end of the year, in accordance with the Memorandum between the European Commission and the Bulgarian Government of 29th November, 1999, and units 3 and 4 - by 2006, provided that the European Commission carries out technical inspection as early as 2003. The Government plans to continue negotiations with the European Commission after the inspection and has stated that it will accept the Commission's position based on the expert assessment of the reactors' condition.

It should be noted that Bulgarian Government's decision is a political one and is not based on arguments about social and economic development, public opinion, or the safety level of the nuclear power plant. For example, closing down the units will increase unemployment in the region of Kozloduy. According to a 2002 sociological survey, over 77 per cent of the Bulgarians are not ready to accept a decision to close down the first four units of Kozloduy NPP<sup>9</sup>. Similar results have been registered in the survey carried out by the Center for Economic Development within the Effect of Reforms in Bulgarian Energy Sector on Consumers Protection Project, where 54 per cent of the interviewed definitely state that the closing down of units 1 through 4 will have a negative effect on the Bulgarian energy sector, with only 3.3 per cent of the interviewed expecting positive effects. The conclusion of the International Atomic Energy Agency in its report on the latest safety inspection of Kozloduy NPP, requested by the Bulgarian Government, is that

<sup>8</sup>Source: <http://www.dnevnik.bg/show/Default.asp?storyid=57779>

<sup>9</sup>Source: Nanov, D., Public Opinion in Bulgaria on the Nuclear Energy Sector in 2000-2002, Energy Forum 2002, Volume I, Sofia 2002



"In respect of units 3 and 4, the implemented modernization program has resulted in a high standard of technical safety, which corresponds and even goes beyond the initial recommendations of IAEA"<sup>10</sup>.

**The Parliament has also formulated an opinion about the destiny of the small reactors**, and with great majority, achieved with the participation of all political forces represented in Parliament, made a decision that the reactors shall not be closed down before the date on which Bulgaria will become a full member of the European Union. This decision changes the essence of Bulgaria's position, as it does not bind units close down with specific dates. At the same time it resulted in lack of coordination between institutions based on different interpretations.

The European Union accepted the Bulgarian Government's position, and Chapter "Energy" was provisionally closed in November 2002.

The progress of privatization in the energy sector found expression in **appointing a BNP Paribas-led consortium to provide consulting in the privatization of the seven electricity distribution companies**. Electricity distribution companies should be privatized within a year. Privatization is expected to improve company management and the quality of services provided to end-users; achieve higher efficiency and provide investments for distribution network maintenance and development.

**The new Safe Use of Nuclear Power Act became effective** in the beginning of the third quarter. It regulates the relations concerning government regulation of the safe use of nuclear power and ionizing radiation and of management of radioactive waste and used fuel. The timely and continuous control and accounting of all aspects of nuclear power usage and all persons and projects subject to control is a fundamental element of the philosophy of this act. Control is assigned to the Nuclear Regulation Agency (NRA),

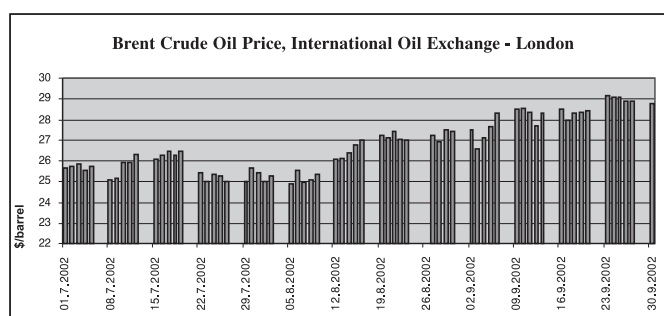
which is a successor to the Committee on Peaceful Use of Nuclear Power. The act restricts the group of persons entitled to use nuclear power to those given a permit and/or license by ERA.

### Energy Prices

**Regulatory and market factors defining energy carriers and energy products price dynamics had different effect on the business in the third quarter of 2002.**

In the period under review crude oil price quotations at international markets were unstable, generally revealing an upward trend. Their dynamics was dictated in the first place by the political activity concerning a possible military operation against Iraq.

Figure 11. Crude Oil Price Dynamics



Source: International Oil Exchange, [www.ipe.uk.com](http://www.ipe.uk.com) <<http://www.ipe.uk.com>>

Higher oil prices result in bigger production costs for Bulgarian refineries, which purchase the raw material under conditions following international markets situation. This has also an impact on oil products prices on the domestic market, mostly affecting production costs of enterprises in the motor transport and the chemical industries.

Three decisions adopted by the State Energy Regulatory Commission (SERC) at the end of the period under review have opposite effect. The first one concerns **the electricity prices, which will be lower on holidays for consumers with annual consumption over 50 million kWh** as of the beginning of October. According to NEC estimates, the consumption of 18 enterprises is above this limit, however only 8 will

<sup>10</sup>Source: Expert Mission's Report on the Survey of Results from Activities Aimed at Enhancing the Security of Kozloduy NPP, Units 3 and 4, 24-28 June 2002, [http://www.bnsa.bas.bg/pdfs/bulgarian/documents/SRM\\_ES\\_Bul.pdf](http://www.bnsa.bas.bg/pdfs/bulgarian/documents/SRM_ES_Bul.pdf)

benefit from the more favorable prices, because the other have unsettled payables towards the company. This NEC-initiated amendment aims at achieving more uniform load of the overall energy system.

The second decision concerns **natural gas price, which is by 2 per cent lower since the beginning of October 2002**. Given the small change, any material reduction of the raw material costs for the business cannot be expected. The main purpose of this reduction is to alleviate as much as possible the financial condition of heating companies, which are entering the season of active consumption of the raw material. According to calculations by SERC, the new price will reduce the costs of heating companies by about BGN 2 million.

The third decision concerns **public lighting, which has been separated in an independent tariff group**. Since the beginning of October municipalities will pay the electricity for public lighting at prices by 4.8 per cent lower than current ones. That will result in a smaller financial burden on municipal budgets and in a higher receivables collection rate for electricity suppliers.

**Amendments to the regulations on the formation and implementation of natural gas, heating and electricity prices** were introduced in July 2002. These contributed to greater clarity in price formation rules. Amendments have not been initiated by SERC, which is competent to define price formation rules. They were imposed by the Supreme Administrative Court's decisions of 18th July, 2002. The Court declared illegal specific texts in these regulations, because they contravened the legal requirement<sup>11</sup> for precise and clear texts of regulations.

Amendments to the regulations did not result in price changes, because they were backdated. Calculation of July bills according to a triple tariff, which would lead to confusion and higher costs for suppliers, was thus avoided. At the same time the approach chosen provokes suspicion in both users and suppliers of

energy resources, because regulatory rules are changed for past periods.

<sup>11</sup>Source: Art. 9, para. 1, Act on Normative Acts.

In the third quarter of 2002 the transport sector had no developments toward substantial improvement of both its efficiency and the benefits it produces through its services to the sectors serviced by it. However, several aspects of government policy should be noted, which will have a positive impact on the business in Bulgaria in the coming months and years.

First, in September the government presented a **draft law on amendment of the Act on Marine Areas, Inland Water Routes and Ports Act** to the Parliament. Envisaged changes concern the development of the ports and provision of port services and introduces the concepts of public transport ports of national and regional importance. This will resolve the problem situations faced by several ports with private ownership performing loading and unloading operations, in spite of the fact that pursuant to law only public property ports are entitled to perform such an activity. Since ports of regional importance may be owned by the central and local authorities, natural persons and legal entities, the draft law eliminates the threat of their nationalization, which could have a strongly negative effect on the business environment in Bulgaria.

The draft law determines the minimum requirements for a port to be defined as "public transport port". Inasmuch as these requirements provide for creating conditions for normal and quality performance of port services, they would contribute to the better quality of services provided to passengers and cargoes passing through the ports.

The proposed amendments specify the procedure for granting concessions for use of port facilities. An important point is the proposed supplement to §3b of the Concessions Act, which excludes the possibility for the Council of Ministers to grant concessions on facilities listed in the Act on Marine Areas, Inland Water Routes and Ports of the Republic of Bulgaria without tender or competition, provided that a sole state proprietor owns at least 25 per cent of the capital of the concessionaire. This amendment aims

at creating more competitive conditions for granting concessions for marine and river facilities, which could produce higher revenues for the state and improve the selection of operators. It should be noted however, that the legal provision for acquiring a special right to use port infrastructure has been used so far, given the objective needs, mainly to improve the quality of port services and compensate for the lack of specific steps in granting concessions on infrastructure to external operators. If this trend continues in the coming months, in spite of the announced intentions of the MTC, the effect of the change on business will be negative.

The draft law provides for the establishment of the National Company "Ports" to manage the port complexes owned by the state. This change is positive inasmuch as the business activities are separated in a specific trade-oriented structure. On the other hand however, the National Company "Ports" will assume control functions over all port complexes for public transport irrespective of their ownership. Thus, the powers of the state company include two functions - of an owner and a regulator - thereby contradicting the philosophy of placing all owners and operators on equal footing. For instance, in exercising the envisaged powers the National Company "Ports" may give a negative opinion on a proposal for expansion of a private port for public transport as this could lead to tighter competition and reduced number of loads from the ports it manages.

**Despite the legally created provision and declared willingness to let private companies operate as carriers and concessionaires of railway infrastructure, no progress has been made in this area.** During the past quarter it became clear that the rules for the development of free enterprise in this subsector are not in place yet, which affects negatively both the business conditions in the sector and business climate in Bulgaria in general. At the same time, the Bulgarian State Railways Company (BDZ) incurs further losses and its inability to attract more passengers and loads deepens its financial

problems. Data on the first half-year announced by the Ministry of Transport and Communications show that passengers and cargo carried by the company have declined by over 22 per cent and 10 per cent for the same period of last year, respectively, and its revenues are 17 per cent less than projections in the business plan<sup>12</sup>. Counteracting these negative trends, the MTC specified which destinations will be closed from the beginning of October 2002. The poor financial condition of Bulgarian State Railways inhibits normal work of the National Company "Railway Infrastructure" as the state carrier is the only payer of infrastructure charges needed for the maintenance of the railway network. Moreover, the financial problems of the Bulgarian State Railways block entry of private carriers as they would take away some of its profitable activities such as servicing of large load suppliers and passenger transportation to and from big cities.

During the reviewed quarter the idea of **liquidating Balkan Airlines and creating a new national carrier** gained publicity. After the big creditors of the company turned down the rehabilitation plan of the trustees in bankruptcy, the Ministry of Transport and Communications started implementing the idea. At the same time a decision was passed on setting up a new national carrier.

<sup>12</sup>Source: <http://www.capital.bg/article.php?broi=2002-35&page=28-35-1>

Several major issues and events focused the attention of experts and filled up media space in the third quarter of 2002. The most important among these are the draft law on telecommunications, finalization of the strategy for E-Government and emergence of new structures within the third sector in the area of high technology and communications. As a whole, the sector did not witness significant changes during the period under review. The most interesting ones are given below.

A major event is the **draft law on telecommunications**, filed by the Council of Ministers. The key points debated between lawmakers and the business community representatives are:

- Unfettered access to the fixed subscriber network or the so-called “last mile access”

This refers to the fixed two-year period after 1st January, 2003 during which the Bulgarian Telecommunications Company (BTC) must prepare itself to make it possible for the unfettered access to the subscriber line. According to the experts who prepared the draft, this could not be done in less than two years, given the scope of technical and organizational activities and the problems relating to finding financing.

- Licensing of VoIP operators (as well as uncertainties about licensing of Internet providers) and the amount of license fees

The possibility for introducing a licensing regime for Internet providers caused concern among companies operating in the business and among global network users in Bulgaria. The lawmakers' choice appears even stranger, given the fact that the issue was considered three years ago by the Supreme Administrative Court and the case was suspended after the order on the licensing of Internet providers was repealed.

**Regulation No. 13 on Determining the Telecommunications Activities subject to Individual Licensing, General License Registration and Free Regime** was amended in early July. The amended version of the regulation provides for some changes in the regulatory regime for telecommunication activities and extends the scope of the activities subject to

general license registration. Interestingly (especially considering the draft law on telecommunications), unlike the repealed regulation, the present regulation does not specify explicitly that the provision of Internet access is among the activities carried on in free regime (see Article 9, paragraph 4).

Another problem that has been on the agenda for quite a long time among Internet users in the country and abroad using the global network is the **registration of domains in the “.BG” area**. Many of those who have tried to get an Internet address with “.BG” extension know that this is a very difficult and long process, requiring quite a sizeable number of documents and waste of time. At the end of September the activity on registration and maintenance of names in the “.BG” area was transferred from “Digital Systems” OOD to “Register.BG” OOD, whereby the administrative work on creating Bulgarian domains is expected to accelerate.

On 20th September registration for **Bulgarian Site 2002** ended. The competition was organized for a fourth consecutive time, aimed at promoting and strengthening the Bulgarian presence in the global network. This year the participants presented 938 sites (in 2001, 2000 and 1999 registered sites amounted to 1,008,736 and 243 respectively), which compete in 9 categories:

- Portal site
- Corporate site
- Institutional site
- Site for online services and communications
- Electronic store
- Personal site
- Entertainment site
- On-line library
- Electronic edition

It should be noted however, that a significant number of popular Bulgarian sites and portals did not take part in the competition as they disagreed with the criteria and the manner of its conduct. The winners got their awards in early November. Earlier in September



another **Web Workshop 2002** took place, aimed to introduce and discuss modern applications of and in the web space and the Internet, as well as to provide opportunities for contact among professionals in the field.

The third quarter of 2002 enriched the Bulgarian third sector with several new associations of the communications and information business. In mid-September the **Association for High Technologies Development** was established. At the same time the **Telecommunications Association (TA)** gained publicity, in which two major companies in the telecommunications business play a key role: BTC and Mobiltel. ASTEL's aim is to promote successful development of the telecommunications market in the future and to protect the interests of the companies in the business.

Also in September the **Bulgarian Association for Telecommunications Development (BATD)** was established. Its founders were Spectre Net, Roys Net, Elana Holding, and Novel Consult.

Given the sizeable number of professional organizations, the Bulgarian user could hope that sector development will accelerate and the work of individual companies will optimize, having an impact on the quality and price of products and services offered on the Bulgarian market.

At the end of August the Agency for Development of Communications and Information and Communication Technology (ICT) in collaboration with the Ministry of Education and Science organized a **national competition for IT projects**. The purpose of the competition was to enable young people (eligible for participation are only youths up to 18) in Bulgaria to present their projects on IT modeling of processes and events. The first two projects will be presented at the International Olympiad on Information Technology to be held in Tbilisi, Georgia from 4th - 8th November 2002. Organizing such initiatives has an extremely positive effect and is one of the genuine examples of

support to gifted students who are broadly expected to build the future of the IT industry in Bulgaria.

Another good news in August was **the excellent performance of the Bulgarian informatics team, which ranked seventh at the International Olympiad in Seoul, South Korea**. More than 70 countries took part in the Olympiad and the results achieved by the Bulgarian participants are yet another proof that in spite of the problems in Bulgarian education in recent years informatics in Bulgaria has preserved its traditionally high level.

At the end of September the **final version of the Strategy for Electronic Government** was put on discussion, prepared by the Coordination Center for Management, Communication and Information Technology in cooperation with experts from the government, business and non-government organizations. The strategy is the first step toward establishing a working electronic government in Bulgaria and work on a plan for its implementation will begin immediately after its adoption by the Council of Ministers. Specific tasks and time frames will be laid down in the plan.

An **international conference** was held in Sofia between 28th and 30th September in which representatives from ministries responsible for science and research in South Eastern Europe took part. Possibilities for development and cooperation among the countries in the scientific and research area and adoption of policies to underpin efforts in the field were discussed at the conference. As a result of the discussions the participants united around the decision to establish a **Regional Research Coordination Committee (RRCC)**. Some of the major tasks to be implemented by the Committee include:

- Coordination of regional joint activities in the scientific and research field;
- Creating an Internet portal of the RRCC (based on the already existing site of the conference) which is to provide up-to-date information about the countries, including statistical data on research; specifics in national legislation; scientific

programs open to the other countries; current projects, etc.;

- Assistance in organizing consulting bureaus for joint work in the field;
- Creating a working group to identify major problems of common interest in order to facilitate work on European and regional programs.

### Number of Tourists and Revenues from Tourism

During the first nine months of 2002 the number of foreign tourists visiting Bulgaria reached 2,443,296 persons, an increase of some 10 per cent on the same period of last year. Tourists from Western Europe accounted for the largest number, Germany ranking first with 454,176 tourists. Notable is the substantially increased number of tourists from the U.K. The number of tourists from the Czech Republic, Poland and Slovakia has also risen, an indicator of a gradually reviving Bulgaria's presence on the Central European market. On the other hand, the number of tourists from Ukraine and Russia has declined.

Data on the first nine months of the year show an increase in the number of **Bulgarians traveling abroad** for tourism: in the period January - September their number exceeded 675,000 persons. The total number of Bulgarian citizens traveling abroad (including for business, tourism and as visitors) was more than 2,400,000 persons, an increase of some 20 per cent on the same period of last year.

**Revenues** from tourism reached USD 665.1 million in the third quarter against USD 589.8 million in the same period of last year. For the period January - September 2002 revenues from tourism amounted to USD 1150.6 million against USD 1049.9 million in the same period of last year, marking an increase of some USD 100 million or 9.5 per cent.

At the same time, Bulgarians' **spending** on trips abroad amounted to USD 477.6 million in the period January - September 2002 against USD 440.6 million in the same period of last year. **The net revenue (balance) from tourism for the first nine months of 2002 totaled USD 673 million against USD 609.3 million in the nine months of 2001, i.e. an increase of USD 64 million.**

**The growing number of Bulgarians traveling abroad offsets to a certain extent the positive balance in tourism.** Turkey remains a key

destination for Bulgarian tourists. The reasons for the greater flow of Bulgarian tourists to our Southern neighbor are affordable prices and the high quality of tourist services. Turkey continues implementing an active policy toward creating better tourist conditions - tax reliefs, low-interest credits, and sizeable funds for advertising abroad. In practice, the prices at Turkish sea resorts are similar to those at the Bulgarian resorts, whereby Bulgarian citizens opt for Turkish resorts. In some cases Black Sea resorts prices for Bulgarians are higher than those for foreign tourists. Overall, experts consider the past summer season as weak in terms of Bulgarians traveling to the Black Sea through Bulgarian tour operators.

According to Bulgarian Chamber of Tourism data, **between January and September 2002 some BGN 280 million were invested in the tourist sector.** As most investments were made primarily for business expansion rather than improving the quality of the tourist product, the level of investments could be considered quite unsatisfactory.

### Legal Framework

In September the Government adopted a **Regulation on the Licensing of Tour Operator and Tour Agency Activities**. In addition, a **Regulation on Categorization and a new Tariff for the Fees Charged under the Tourism Act** were adopted. The Act, the Tariff and the Regulation came into force as of 1st October, 2002. These documents provide for the following:

- The tour operator license will enable the company to operate also as a tour agency;
- In order to perform agency business, tour operators must prove before the Ministry of Economy and the licensing authority that they meet the requirements for premises, trained personnel and conditions for business development;
- Tour agencies may be granted tour operator license on paying the residual amount of the charge for the license issue (until now the companies willing to operate both as tour agencies and tour

- operators had to pay for two licenses);
- After the 1st January, 2003 tour operators will be obliged to offer insurance contracts;
- The adopted Tariff for the fees requires that the statistics, reporting and analysis of bed stock be made on the basis of the number of rooms instead of the number of beds. This change will have no bearing on the patent tax;
- The single charge for licensing and categorization is preserved; 10 per cent of it is paid upon filing the application and the remaining amount, on issuing the license;
- Higher requirements in the categorization of individual tourist sites;
- Higher requirements for professional and language qualification of personnel, hotel-keepers and tour operators.

The main objective of the regulatory documents is to create better prerequisites for improving the quality of the Bulgarian tourist product. Therefore, their adoption represents a positive step in general.

**The major problems** that still affect the tourist sector are the lack of well organized advertising abroad and inability to attract and preserve Bulgarian tourists in the country, combined with ongoing illegal construction on the beaches and underestimated possibilities for entertainment and sports at tourist complexes. These problems, combined with the poor condition of the road infrastructure had a strongly negative effect on the high tourist season in the third quarter of the year.

The quality of the Bulgarian tourist product remains low - the advantages of Bulgarian tourism in this season reflected to a large extent the price/quality ratio - relatively poor quality of service and a corresponding price. At the same time, competition from new tourist destinations enhanced - Croatia, Slovenia and Monte Negro - along with traditionally strong Greece and Turkey. **In the conditions of growing international competition the Bulgarian tourist industry should improve the quality of tourist services in order to preserve its competitiveness.**

## Current Condition of the Agricultural Sector

**Although third quarter data on the share of the agricultural sector in GDP and GVA are still not available, projections point to an unchanged or slightly increased share compared to the second quarter** (some 11-11.5 per cent of GDP and 10-10.5 per cent of GVA, respectively). The projection for the number of the employed in the agricultural sector is similar. (The Ministry of Agriculture and Forestry estimates the total number of those employed in agriculture at over 230,000 persons or 8.7 per cent of the active population in Bulgaria.) Although it is hardly possible to speak of a real land market, the number of land deals is growing, coupled with higher prices per decar. Land supply still prevails over demand, due mainly to great difficulties in consolidating land, given unsettled relations between heirs and traditionally fragmented property. In these conditions it is difficult to set up stable production units (farms) capable of creating conditions to achieve new quality standards and technological rollover. Without these product competitiveness will remain low and the EU criteria for agricultural support will not be achieved. The lack of sustainable agricultural farms underlies the weak performance of the SAPARD program: by the end of September, 2002 only 42 projects were completed and subsidies of BGN 16 million were utilized. Even if the expected BGN 75 million were to be utilized by the end of the year, this would be well below the extended EUR 54 million per year.

Export of agricultural products grew with the quantity of exported bread-wheat from the current year crop exceeding 335,000 tons. Wheat produced in the country is estimated at some 3.5 million tons, and the surplus from this and previous years is estimated at some 1 million tons. Negotiating a larger quota of wheat from the new crop for duty-free import to the EU the quantity of exported wheat could rise substantially. The negotiations of a bigger quota is expected to result not only in increasing the areas sown with corn, currently accounting for 14 million decars, but also in higher yields and better quality of the agricultural

products. The major problem for exports is the strong dependence on price fluctuations on the international market and the weak US Dollar, consistent with the falling share of processed products and low competitiveness of agricultural products.

## Environment for Development

In compliance with the Program for Accelerated Negotiations with the EU and adopting the European schemes for farmer support and development of rural areas, the Ministry of Agriculture and Forestry put forward a **draft for amendments to the Farmer Support Act**. The Act provides for "Zemedelie" State Fund to assume the functions of an intervention agency to intervene on the market for agricultural products by purchasing domestically produced unprocessed agricultural produce at intervention prices. The produce will be stored in warehouses approved by the Fund, contracts will be signed with them and tender sales will be conducted. Every year by the 1st of August the Council of Ministers will determine the items to be purchased by the Fund, the period of intervention, the prices and the minimum quantities. To boost production, the Fund will grant export subsidies to exporters of processed and unprocessed agricultural products through public tenders. To this end, exporters will be granted export licenses for export term, product quantity and quality, customs checkpoints and export destination.

**By a Council of Ministers' Decree a wheat stock fund was established and budget funds were provided from the state budget for intervention in the corn market and for subsidizing export-oriented corn producers.** The Fund will provide money for the purchase of 200,000 tons of wheat meeting specific quality requirements directly from producers in quantities requested in advance. Corn purchased from the Fund will be sold subsequently through tender to cover budget spending. The second measure in the government package - granting subsidies to export-oriented corn producers - aims at boosting export of quality corn and tighter control



on the producer-exporter chain through a more direct contact between producers and exporters. The third measure is associated with improving the quality of production on the basis of the seed subsidy granted. This would boost selected seed production and efficiency in the corn sector. Now it is important for the Ministry of Agriculture and Forestry to ensure effective monitoring on subsidy granting and use, so as to assure that the desired effect will be achieved without creating conditions for non-competitive agents to enter the market and the number of unprofitable farms to increase.

**A Regulation amending Regulation No. 30 on the Veterinary, Sanitary and Hygiene Requirements for Raw Milk Production** was adopted. It determines the conditions for construction and operation of milk processing enterprises, for production and trade in thermally processed milk and dairy products. The adopted changes aim to harmonize Bulgarian legislation on the milk sector with the European one and achieve the high European standards for raw material quality through observance of strict sanitary and hygiene requirements by milk producers and processors. This will help increase the number of licenses for export to the EU, currently totaling only nine, and ensure better performance of the extended quota.

With a view to supporting and regulating wine production a **Regulation on the Terms and Procedure for Planting New Grape Vines, Replanting, Grafting and Uprooting of Existing Grape Vines** was adopted. Its provisions concern only legal entities and natural persons entered in the register of producers at the National Chamber of Vines and Wine. The farmers who do not produce wine grapes and wine for family consumption and do not sell produced wine are not subject to the provisions of the Regulation.

To protect domestic producers, as of mid-August **seasonal customs duties on the import of eight types of vegetables were imposed**, which are used for processing in the canning industry. Thus, customs duties were raised to those agreed within the WTO.

The need for imposing such customs duties in the high season, when the Bulgarian produce is so cheap that it is hardly competitive on the market provoked hot debates. Only an in-depth analysis of the market situation in the season would answer the question whether market turmoil was caused by the dumping import or by unfair competition and pressure from wholesale traders. The conclusions of such analysis will give sound arguments in the hands of the executive branch with a view to subsequent intervention on the market.

**In the course of implementation of the SAPARD Program three changes of the application procedure were introduced**, aimed at alleviating applicants. First, opportunity is provided for applicants to rectify technical errors in the project dossiers within 10 days. Second, an agreement is reached with the European Commission for the sessions of the Commission on Approval of SAPARD Projects to be held once monthly. Third, specialized regional agencies for processing applicant documents will be put in place. As of the end of the third quarter the total number of approved projects was 227 and projected investments exceed BGN 158 million. The major problem to be resolved is accelerating the process for development, presenting and approval of the projects in order to utilize provided funds.

**Two major positive trends evolved in the third quarter of the year. First, a new legal framework for trade in compensatory instruments was introduced.** The benefits could be twofold - attempting to use the advantages of the existing arrangements on the Bulgarian capital market in practice would boost the market itself. **Second, the SOFIX index continued its steady rise.** This, in combination with increased liquidity of some securities included in the index, may be viewed as a sign of improved indicators of public companies, better corporate governance or at least market adjustment of the prices of Bulgarian shares, which had been understated for years.

**Generally the share of the capital market in Bulgaria's financial sector remains insignificant, however.** As of end September 2002 total market capitalization on the floor of the Bulgarian Stock Exchange - Sofia AD was 3.5 per cent less than the adjusted GDP forecast (BNB and MF estimates) for 2002. The underdeveloped capital market reflects both the condition and the prospects for the Bulgarian economy as a whole and the fact that the mechanisms of financing through an alternative non-banking medium are still unfamiliar and not preferred even when relevant projects are in place. As a result, **liquidity remains low, the market does not stimulate good corporate governance practices, and investment alternatives are limited. Financial intermediation is carried out mostly through the banking sector.**

#### **The Capital Market Based on Bulgarian Stock Exchange - Sofia AD Indicators (without the market for compensatory instruments)**

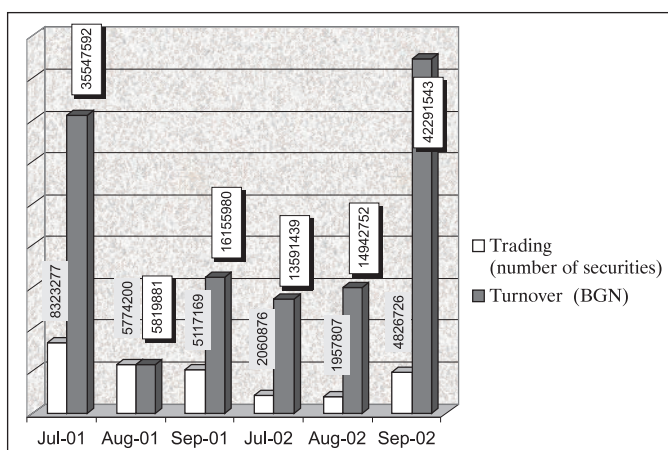
According to stock exchange data, as of 30th September market capitalization totaled BGN 1,025,580,832 (including BGN 212,630,824 on the official markets), and at the end of the second quarter of the year market capitalization accounted for BGN 1,289,279,147 (including BGN 211,702,461 on the official markets). Turnover in the third quarter of 2002 was BGN 70,825,734 at 8,845,409 traded securities (compensatory instruments are not included in trade

turnover and volume but block deals are included again without compensatory instruments). The SOFIX index as of 30th June was 132.15 to reach 149.82 as of 30th September, 2002.

With the exception of the index, **the third quarter of the year did not see positive movements in the market indicators characterizing the condition of the capital market in Bulgaria** (traditionally understood and measured through the Bulgarian Stock Exchange - Sofia AD indicators). Excluding compensatory instruments but including block deals, turnover in the third quarter of the year was lower than in the second one, despite higher trading volume. Liquidity remained a major problem for stock exchange trading - for example, in September more than two-thirds of the official market turnover resulted from one deal (with shares of "Bentonit" AD), and approximately one fourth of the unofficial market turnover was accounted for by one deal (with shares of "Elenite" AD).

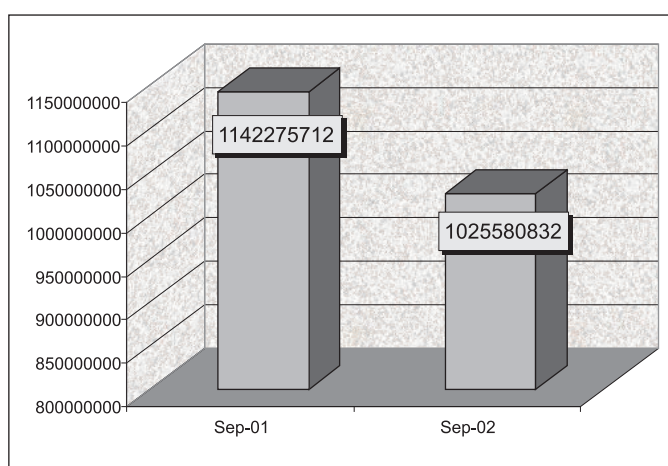
Market capitalization fell as of end-June. A traditionally weak summer season is a typical Bulgarian market abnormality; nevertheless, comparison with last year's same period does not give ground for optimism. In terms of turnover, trade on the Bulgarian Stock Exchange - Sofia AD in the third quarter of 2002 marked a positive development compared to the same period last year, but market capitalization at the end of the two periods and especially trading volumes decreased (Figures 12 and 13). **Overall, the simultaneous fall in volumes and capitalization against increasing turnovers reflect ongoing trends of ownership expansion and trade concentration on a smaller number of issues at the expense of lower liquidity of most of the listed securities. However, the quarter under review exhibited higher liquidity for some securities included in the calculation of the SOFIX index. Definitely, this is a positive trend.**

Figure 12: Trading on the Bulgarian Stock Exchange - Sofia AD  
(third quarters of 2001 and 2002)



Source: Bulgarian Stock Exchange - Sofia AD data, monthly bulletins

Figure 13: Bulgarian Stock Exchange - Sofia AD Market Capitalization (at end of period, BGN)



Source: Bulgarian Stock Exchange - Sofia AD data, monthly bulletins

The most important corporate news in the second quarter was the publication of the annual financial statements (and later annual meetings) of some most traded companies, while in the third quarter the semiannual results and consolidated annual reports of holdings were expected. Many of the companies did not publish their reports on time, whereby the need of **improving accounting and regulatory corporate governance practices is an issue that still remains on the agenda**. Probably, the main reason for this observation is that **dependence of traded companies' prices on publicly announced corporate events on the Bulgarian market remains controversial**.

In the third quarter of the year **the corporate bond market** on the Bulgarian Stock Exchange - Sofia AD remained flat. In August the first issue of mortgage bonds of Bulgarian Post Bank AD was registered for secondary trading, totaling BGN 12,000,000, distributed in bonds of BGN 1,000 nominal value and a coupon of 7.625 per cent on an annual basis with semiannual interest payments. The issue is three-year, maturing on 22nd May, 2005. The decision on issuing bonds of Varna Municipality (in the amount of EUR 3 million, and for the time being the issue would not be public), as well as confirmation of the prospectus of the public bond issue of Sliven Municipality (in the amount of BGN 3 million, public issue) enhanced interest in the municipal bond market to a certain extent. The two issues added to the only two issues of municipal bonds - those of Greater Sofia Municipality and Svishtov Municipality of 1999. (In early October Pazardjik District Court ruled on the suit filed by the investment intermediary "Status Invest" AD against Pazardjik Municipality regarding the April public order for the preparation and placement of a municipal bond issue. Based on such a ruling it is possible that Pazardjik Municipality may not announce a new procedure and seek other sources of financing.)

### Trading in Compensatory Instruments, Privatization via the Stock Exchange and Development of the Legal Framework

In July the Council of Ministers adopted an **annual list of 1,073 state-owned companies, shares of which would be put up for sale (through different privatization methods, including public offering on the stock exchange) against compensatory instruments and investment vouchers**. Meanwhile, some bylaws were adopted, regulating the issuance and trade in compensatory instruments.

The measures are expected to have a positive effect on the development of the capital market in the next months. Expected positive implications are in two dimensions. The new regulation of trading in compensatory instruments and concentration of

trade on the Bulgarian Stock Exchange - Sofia AD in particular would contribute to greater transparency and clear price setting, increased liquidity and hence indirectly, to revived confidence in securities trading and the capital market as a whole. Moreover, the sale by the state of new packages through the stock exchange against non-cash instruments of payment would enhance credibility in the privatization process and interest in the stock exchange.

**Undoubtedly, the launch of trade in compensatory instruments on the floor of the Bulgarian Stock Exchange - Sofia AD was among the major events** in the capital market field in 2002. Positive expectations have materialized so far, as is clearly evident from the first weeks of trading.

At the end of August the Board of Directors of the Bulgarian Stock Exchange - Sofia AD passed a decision to register compensatory instruments (on the "Unofficial Market", the "Market for Compensatory Instruments" segment). Trading was launched in the three securities issues comprising the group of compensatory instruments under the Trade in Compensatory Instruments Act, including compensatory notes under the Compensation of Owners of Nationalized Properties Act, residential compensatory notes under the Compensation of Owners of Nationalized Properties Act and registered compensatory bills under the Ownership and Use of Farm Land Act and the Restoration of Ownership of Forests and Forestry Fund Land Act.

With the adoption of the Trading in Compensatory Instruments Act in early 2002, issuance, trade and payment in these securities was discontinued. After a certain delay and non-compliance with the original legal time limit on 2nd September, 2002 trading in compensatory instruments launched again. Trading in compensatory instruments is effected only on the stock exchange floor and the initial interest (as well as expectations about pending privatization transactions with huge blocks, including payment with compensatory instruments) contributed to price rises well above

close trading levels in June.

Statistics on the third quarter, at the end of which stock exchange trading in compensatory instruments started, reveal the following results. Overall, from 2nd September till 30th September 716 stock exchange transactions in compensatory instruments were closed, accounting for BGN 6,963,876 in turnover. Apart from this, block deals with compensatory instruments went through the stock exchange floor: three transactions with registered compensatory bills of BGN 1,799,006 in total turnover. In September compensatory instruments traded (block deals excluded) at a price of 18 to 35 per cent of nominal value, the highest price (35 percent of nominal value) being attained for residential compensatory notes; in terms of volume and turnover trading in registered compensatory bills prevailed. The average attained price (block deals excluded) for the month was 0.19 per cent for registered compensatory bills and compensatory notes and 0.21 for residential compensatory notes.

While trading in compensatory instruments intensified and interest in the opportunities of the organized capital market revived, **absent clarity on the issue of stock exchange privatization** questioned the prospects, at least in medium term, for a turnaround in the Bulgarian capital market. At least at the beginning of the third quarter the conclusion was reinforced by the fact that in practice all time limits of the new governmental Program for Capital Market Development and Encouragement in Bulgaria were not observed.

Adoption of the annual list of 1,073 companies in July should be considered in light of the comprehensive **governmental policy of boosting the capital market**. In essence this decision supplemented another list, adopted earlier in 2002 by the Committee on Structural Reform, containing blocks of shares and companies for stock exchange privatization. This list remained non-public, despite numerous comments and official statements on it. Consequently, the new list of companies for privatization against non-cash instruments of payment initially did not allow definite



forecasts on the emergence of new companies for trading on the Bulgarian Stock Exchange - Sofia AD. There were two major reasons behind. First, the procedure for converting them into public companies obviously would have required time. Second, there were fears that additional changes in the list for privatization against compensatory instruments and investment vouchers would follow (including the section on stock exchange privatization).

Fears were justified to a certain extent. At the end of September the Privatization Agency resolved on determining public offering as the privatization method for 85 companies (mainly minority packages from them). It is envisaged that these companies be grouped and sold in pools. Actually, this was a reduction of the initial list for stock exchange privatization; therefore the financial community was disappointed. The development with the open competition for selection of a consultant and investment intermediary for the sale through the stock exchange of stakes in some of the most attractive companies for portfolio investors, announced in August (and completed in October), was none the less controversial. This pool contains stakes (from 12.8 to 49 per cent) in the State Insurance Institute - DZI EAD, Bulgarian Maritime Shipping Company EAD (Parahodstvo Bulgarski Morski Flot EAD), Exploration and Extraction of Oil and Gas EAD, Bulgartabac - Holding AD and BTC EAD. Probably with the exception of Exploration and Extraction of Oil and Gas EAD stock exchange privatization of the remaining stakes in the pool remains uncertain.

Meanwhile the State Insurance Institute - DZI EAD - was privatized and the new majority owner does not allow for the time being the remaining minority stake of the state to be sold through public offering as this would mean that the company would acquire public status, which is not desirable for the owner. In the privatization agreement with the new owner there is no relevant clause to this effect and, despite the decision on public sale of the residual state interest, in practice this would not be possible.

Developments in the privatization procedures for Bulgartabac - Holding AD and BTC EAD do not provide clarity as to whether stakes in these companies would be included in the stock exchange privatization pool. As far as the Bulgarian Maritime Shipping Company EAD (Parahodstvo Bulgarski Morski Flot EAD) is concerned, potential investors could be influenced by the purchase of Varna Shipbuilding Yard AD and the impact the purchase could have on the financial performance of Bulgarian Maritime Shipping Company EAD (Parahodstvo Bulgarski Morski Flot EAD).

The issue on privatization development through the Bulgarian Stock Exchange - Sofia AD and expectations for boosting the capital market could be supplemented by the procedure for the sale of 72 per cent of the capital of Saint Constantine and Saint Helena AD of Varna. This privatization was expected with great interest inasmuch as it envisaged for the shares of the company to be sold namely on the stock exchange against compensatory instruments. However, after selecting the intermediary for the sale of the stake, in September the Privatization Agency announced a second competition for the selection of investment intermediary. Its motives reflected the newly emerged fact that the privatization of Saint Constantine and Saint Helena AD was to be carried out only against compensatory instruments (not through the more general method of public offering through the stock exchange). Consequently, the decision on a second procedure evoked negative comments and caused a change in capital market actors' expectations.

**Expectations about the legal framework** may be considered the last element of the environment for capital market development. Specifically, this involves two draft laws - **the Act on Companies with Special Investment Purpose and the Financial Supervision Commission Act**.

The first draft law was adopted at first reading on 1st October 2002. It is hoped that the draft law would make a breakthrough in the environment for capital market development in Bulgaria, both in terms of



providing for the establishment of companies with special investment purpose and generally with the introduction of underlying norms of asset securitization in Bulgaria. Creating investment alternatives and boosting collective investment schemes are among the additional motives for the draft law. The draft law on the financial supervision commission was adopted at first reading at the end of the third quarter. The draft law treats the integrated supervision over the non-banking financial sector in Bulgaria - capital market, insurance and fully funded social insurance. Cost cutting, slashing existing administration and increasing efficiency are the main motives behind the idea of integrated supervision. Currently, intensive discussions both on the essence of the idea of a single supervision authority and in terms of eradicating existing shortcomings of the draft law from legal and technical viewpoint, which might inhibit the present regulatory and supervisory practices or the future construction of the new supervision authority, are underway.

Improving the legal framework and other government policy manifestations are traditionally present in the review of the Bulgarian capital market. One of the reasons is that the market is still incapable of outgrowing the initial stage of development to evolve into a genuine alternative to bank intermediation or a medium for boosting investment. As a result the **capital market became one of the areas by which the overall economic policy of the government is evaluated**. This critical view on the capital market comes against the backdrop of the typical of Bulgaria expectation for support from the state as well as against the clearly announced intentions in 2001 for a more active government policy in support of market development.

The conclusion is that **the objective condition of the capital market (based on trade performance on the Bulgarian Stock Exchange - Sofia AD), the review of the environment for development and the government policy itself give ground for controversial evaluations**.

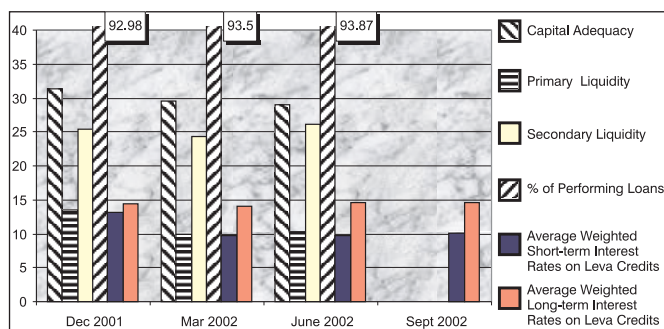
**Expectations for the development of the market in the medium term continue to be associated with prospects for privatization via the stock exchange and specifically with the new legal framework for transactions in compensatory instruments.**

The banking system dominates Bulgaria's financial sector. The condition of the banks in Bulgaria continues to be characterized as stable, with excellent capital adequacy and liquidity indicators, and at the same time the bank supervision functions well. As of the end of September 2002 in Bulgaria there are 35 banks of which 27 banks have a license to conduct business in Bulgaria and abroad, one bank has a license to perform activities only in Bulgaria, and seven are the branches of foreign banks.

### Banking System Indicators

According to data from the Bulgarian National Bank (BNB) as of the end of September 2002 the banking system assets amounted to BGN 13, 475, 455, 000, while as of the end of June they amounted to BGN 12, 394, 798, 000 (this is a BGN 1, 080, 657, 000 increase in the third quarter of 2002). As of the end of September total deposits amounted to BGN 10, 527, 760, 000, while as of the end of June they were BGN 9, 632, 734, 000 (an increase of BGN 895, 026, 000 in the third quarter of 2002). The current profit of the banking system for September was BGN 201, 740, 000, while for March 2002 it was BGN 56, 996, 000, and for June 2002 – BGN 132, 715, 000. In the last month of 2001, however, the current profit of the banking system was BGN 319, 375, 000. According to the latest data available from BNB, total capital adequacy of commercial banks as of the end of June 2002 was 28.98 (Group Five excluded), while this indicator had a value of 29.52 per cent as of the end of March 2002 (and 31.32 as of the end of 2001). As of the end of June 2002, the primary liquidity for the banking system as a whole was 10.27 per cent, and the secondary liquidity was 26.15 per cent (as of the end of March 2002 these indicators were 9.99 и 24.25 per cent, accordingly, and as of the end of 2001 – 13.47 и 25.47 per cent, respectively). These indicators are shown in Figure 14 below.

Figure 14. Selected Banking System Indicators (%)



Source: data from the BNB, monthly information newsletters

Thus the banking system as a whole had an increase of assets and deposits, as well as of current profit in the third quarter of 2002. Current profit of the banking system increased in recent months, however in September it was still smaller than in December and September 2001. This is mostly a result of lower revenues from interest, which is a sign of underdevelopment and insufficient diversification of banking activities. As of the end of June capital adequacy indicators were lower compared to the end of March and the end of 2001, but nevertheless they were relatively very high and indicated the stability of the system. Liquidity indicators for June registered diverse trends since the end of 2001, but generally they were better than the corresponding indicators for June 2001. All this, again, can be interpreted as an indication that **the banking system of Bulgaria is stable, but short-term trends are contradictory and at the same time the system remains barely efficient and underdeveloped**. This conclusion is indirectly confirmed also by the review of banks' lending activity.

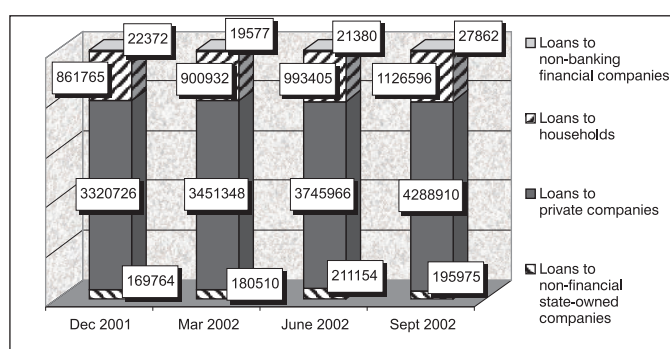
### Lending Activity

Given the unavailability of many of the products and services offered by similar institutions in the West, lending activity is actually considered to be one of the key indicators of the degree of development of the banking system and its efficiency. **Loans to the non-government sector show a clear upward trend** (under the currency board arrangements these are the loans extended by commercial banks, which

include loans to non-financial state-owned companies, private companies, households and non-banking financial companies). At the end of 2001 receivables on loans to the non-government sector amounted to BGN 4, 374, 627, 000, and from that level they reached BGN 5, 639, 343, 000 at the end of September 2002. Newly negotiated loans from commercial banks in the first nine months of 2002 amounted to a total BGN 3, 662.8 m., while for the same period of 2001 they amounted to a total of BGN 2, 721.5 m. **The loan portfolio quality is also improving** - while at the end of 2001 92.98 per cent of all types of loans in the banking system were classified as performing, as of the end of March 2002 this indicator was 93.5 per cent, and as of the end of June 2002 - 93.87 per cent (Figure 14).

**In September 2002 interest rates on short-term loans denominated in BGN decreased compared to the end of 2001, however those on long-term loans denominated in BGN remained practically unchanged (again Figure 14). Loans' dynamics shows further interesting short-term trends** (in terms of currency, maturity term, and borrowers). For example, the review of loans to the non-government sector shows an increase in the loans exposure to both private companies and households, however their relative shares remain almost unchanged (Figure 15).

Figure 15. Loans to the non-government sector (in thousand BGN)



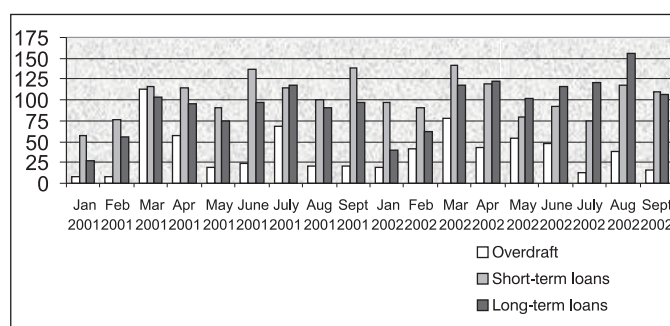
Source: data from the BNB, monthly information newsletters

2002. In the first nine months of 2002 newly negotiated loans registered a trend of general increase compared to the same period of 2001, which however is not so pronounced in respect of loans denominated in BGN.

In respect of maturity terms, long-term loans prevailed in the third quarter of 2002, which was however more pronounced in respect of loans denominated in USD. This is rather an indication of higher investment activity in the country and certain exchange rate risk (under the conditions of a currency board and the Euro as a reserve currency for Bulgaria) than of interest structure dynamics. In the third quarter of 2002 newly negotiated long-term loans denominated in USD definitely exceeded short-term ones.

The above may be interpreted as an indication of the condition and prospects of the Bulgarian economy as a whole, or in particular, of the attractiveness of investment projects. With the development of economy and the occurrence of specific projects, along with expansion of competition and the efficiency in the banking sector per se, more intensive long-term lending to the private sector may be expected. **At the same time, the more intensive lending to households is only one of the indicators of the recently observed development of retail banking. In spite of some objective indicators of an improvement trend, the assessment prevails that the lending activity of banks in support of companies, including small and medium-sized enterprises, is still weak.**

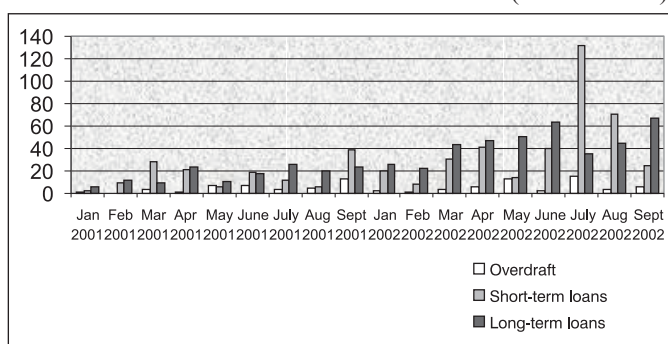
Figure 16: Newly Negotiated Loans from Commercial Banks in BGN (million BGN)



Source: data from the BNB, monthly information newsletters

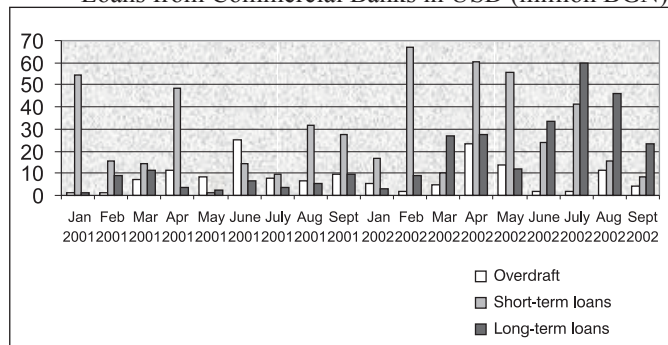
Figures 16, 17, and 18 show the dynamics of newly negotiated loans for comparable periods of 2001 and

Figure 17: Newly Negotiated Loans from Commercial Banks in EURO (million BGN)



Source: data from the BNB, monthly information newsletters

Figure 18: Newly Negotiated Loans from Commercial Banks in USD (million BGN)



Source: data from the BNB, monthly information newsletters

However the availability, or shortage, as the case may be, of good projects is not the single problem with bank loans. What is of importance also is the strongly conservative policy in the recent years affected by the 1995-1997 bank crisis aftermath and manifested in highly raised and often difficult to meet requirements to loan collateral. Some of the hopes for a more intensive lending activity are related to the amendments to the statutory framework which were passed several months ago and are aimed at fostering bank lending. For example, the amendments to the Corporate Income Tax Act exempted bank loan interests from the regulation on poor capitalization. The amendments to the Penal Code removed criminal liability of bank managers responsible for the granting of certain loans.

## Restructuring and Privatization in the Sector

The analysis of the Bulgarian banking system should obligatory take into account also the ownership restructuring of the recent years. Through different channels such as privatization, opening of representation offices, branches and newly established banks, **the foreign participation in Bulgaria's banking system is already prevailing both in the equity control and in the assets under management.** According to the data published by the BNB<sup>13</sup> private banks account for 80.1 per cent of total banking system assets as of the end of 2001. The group of foreign banks (which constitutes only a part of the foreign participation in the Bulgarian banking system) in 2001 held 8 per cent of the assets, 8 per cent of the deposits, and 15 per cent of the loans in the banking system. In 2001 foreign investors had control over three times larger banking assets than local investors.

In recent months serious progress was registered in the privatization procedures for the last two large state-owned banks, foreign investors and consultants having a leading role again. At the end of June the Bank Consolidation Company approved the contract for the sale of TB (Commercial Bank) Biochim AD (Joint Stock Company) to Bank Austria. The contract was signed at the end of July - 99.59 per cent of the capital of TB Biochim AD was sold for EUR 82.5 m. Until recently the banking group Bank Austria Creditanstalt was present in Bulgaria via its subsidiary group HVB Bulgaria. The buyers' scheme envisages merger of the daughter bank with TB Biochim, whereby the total market share will reach around 7 per cent. **With the privatization of TB Biochim the foreign participation in Bulgaria's banking system reached almost 85 per cent of the banking system assets.**

At the end of the second quarter expired the deadline for submitting tenders under the bidding procedure announced by the Bank Consolidation Company for selection of a consultant for the privatization of DSK Bank AD (State Savings Bank Joint Stock Company).

<sup>13</sup> Source: BNB's 2001 Annual Report



In July five potential candidates were short-listed, from among which, on the basis of additional presentations later on, the final consultant, namely J P Morgan, was selected. The final contract was signed with the consultant in early October. Just after the end of the quarter, in October, and after the corresponding changes of legislation, the state-owned share of 75 per cent in DSK Bank AD was transferred to the Bank Consolidation Company and thus the sale may be finalized. Indicative offers by the candidate buyers are expected by the end of the year and the realistic term for the sale of DSK Bank AD is the beginning of 2003.

### Statutory Framework Development

**Amendments to the legal and the related regulatory framework were made in the third quarter of 2002. The two drafts of Amendments to the Banking Act put forward to the National Assembly in March 2002 were passed in July.** The first one proposed removal of the restrictions regarding the type of educational background required for bank managers. According to the arguments submitted by the proponent this proposal is in the light of the policy for banking sector liberalization, and it repeals the unnecessary restrictions to the conducting of banking activities. The removal of some restrictions generated a lot of discussions, however, after promulgation of the Amendments to the Banking Act, it is already a fact.

The second draft was aimed at granting wider powers to the BNB for exercising control over the offshore shareholders in the banks that hold 3 per cent and more of the voting shares. The proposal was justified with the need to strengthen the bank supervision, to ensure transparency in the shareholding structure, and to comply with international regulatory standards. This Amendment to the Banking Act was also passed in the third quarter of 2002. Some banks already carry out transformation of the share capital with a view to comply with new requirements.

In September the National Assembly passed a **Bank Bankruptcy Act** (promulgated in the Official Gazette at the end of the same month). The delay of this Act was among the problems pointed out in the review of the latest agreement with the IMF. The draft was introduced as early as September last year. Pursuant to the new Act the administration of the bankruptcy proceedings for banks is assigned to the Bank Deposits Insurance Fund. New control on the receivers' activities is introduced and the functions related to it are assigned again to the Bank Deposits Insurance Fund.

**A draft law for Amendments to the Bulgarian National Bank Act** was put forward in the National Assembly in June. The main proposal therein was that opening and closing down of BNB branches in Bulgaria and abroad should be done only with the prior approval of the National Assembly. It proposed also that BNB branches should have the powers to sell and buy government securities. A second draft for Amendments to the Bulgarian National Bank Act was introduced in the beginning of the third quarter, namely in July. It proposed that the BNB head office and branches should be explicitly written in the act.

Both draft laws are justified by the willingness to counteract BNB's resolution for closing down three of its regional branches - in Rousse, Bourgas, and Vratsa. Although the Managing Board of BNB passed a resolution to that effect as early as in 2001, the deadline for closing them down in October of the current year was coming closer, which aroused dissatisfaction among those concerned and resulted in a violent public response on the part of affected officers in some regional branches. Representatives of BNB itself strongly objected to such ideas<sup>14</sup>. On the one hand, they justify their resolution with the need to optimize the regional structure and to generally increase BNB efficiency. On the other hand, BNB views the draft law as an encroachment upon the independence of the Central Bank of Bulgaria.

<sup>14</sup>See Interview with Sv. Karaneshev, Director General, Issues Management, BNB, for Econ.bg, 17 July. Available at Error! Reference source not found.



The issue of BNB's regional branches was subject to extensive media coverage in the summer months. As a result of the strong pressure BNB took a trade-off decision in the long run. In the beginning of September BNB's Managing Board adopted a resolution whereby it partially revised its previous position - the regional branch in Vratsa was closed down, and the regional branches in Bourgas and Rousse were transformed into representation offices of BNB without powers to carry out cash-related activity.

**The Amendments to BNB Ordinance No. 3 on non-cash payments and the national payment system took effect in the third quarter. That was actually the last step preceding the introduction of the new payment system for real-time gross settlement.** The new system will allow immediate processing of payments within seconds. Every bank will be able to continuously follow the movement of the amounts in its accounts and to respond in the event of lower liquidity. The system should be completely built within a year. Bankservice will continue to service clients' payments that do not require real-time settlement.

## Social Security

In the third quarter of the year the new draft of the **Ministry of Labor and Social Policy (MLSP) and the State Insurance Supervisory Agency (SISA) for a Social Security Code, to come into effect at the beginning of 2003, evoked constructive public dialogue with a view to solving the problems and developing pension insurance activity. It aims to establish uniform legal framework of public relations in the social security field excluding health care insurance.**

**The proposed changes in the Act on Amendment of the Mandatory Social Insurance Code** aim to reinforce the Bulgarian model of supplementary pension insurance, creating more specific conditions to guarantee the funds and interests of the insured and enhancing public transparency and credibility. The draft law does not provide for changes in the provisions on state public insurance but only for changes in legislative acts regulating supplementary mandatory pension insurance. The new Code includes the provisions on supplementary voluntary pension insurance contained in the currently effective Supplementary Voluntary Pension Insurance Act and creates new texts treating voluntary insurance for unemployment and professional qualification.

Tightening government control on private pension funds met strong resistance among the pension companies. The association of the supplementary pension insurance companies declared many texts as unacceptable provisions, inhibiting long-term planning. **The controversial points in the draft** refer to the investment regime of the companies, increased powers of the State Insurance Supervision Agency, the requirement for the minimum return on invested funds to be covered entirely with the company's own funds, setting up a reserve fund to cover the pensions of those who outlive actuarial estimates, the envisaged requirement that only one custodian bank may keep the funds of one pension fund, the envisaged increase in the minimum equity require-

ment of the companies and up to pension schemes for supplementary pensions.

Instead of liberalizing the investment regime of pension companies, the new Social Security Code in practice envisages an increase in **mandatory investments in government securities**. At present the Mandatory Social Insurance Code provides for at least 50 per cent of the assets of occupational and universal pension funds to be invested in government securities or bank deposits, and the draft envisages at least 50 per cent of the assets to be invested only in government securities. The limit set for bank deposits is up to 25 per cent and in the new Code bank instruments are treated as a separate investment instrument, given the higher risk involved in comparison with the risk on securities issued or guaranteed by the state.

**Investments in real estate** proved to be a contentious issue. Effective legislation provides for investment in this instrument of up to 5 per cent of the assets for second mandatory pension and up to 10 per cent of the assets for voluntary funds. With the new Code the state preserves these limits but introduces the concept of investment property. The purpose is not to allow investments in real property for private needs of the pension company or in favor of related persons. Often pension companies invest insured persons' funds in real property to use it for office needs, for example.

The state imposes restrictions on **investments in mortgage bonds, shares and corporate bonds and does not allow mandatory second pension funds to invest money in the so-called "other financial instruments."** They are permitted to invest up to 2.5 per cent of their assets in put options, as they will play the role of a buffer against market price fluctuations.

A higher percentage is envisaged for **investments abroad**: 15 per cent of total assets for supplementary mandatory pension funds and up to 20 per cent for

supplementary voluntary pension funds.

Pension companies opposed **tighter SISA functions**, as these would make it possible for SISA to interfere in the operational activities of the companies, not allowing them to distribute dividends or forbidding shareholders to exercise their vote.

**Minimum return** is another strongly opposed provision in the draft law. The draft Social Insurance Code provides for the amount of the minimum return of 60 per cent of the average return of all mandatory funds to remain unchanged but be guaranteed through a special reserve fund. The company with own funds must establish the reserve fund, which shall be not less than 1 per cent of the assets managed by the supplementary mandatory fund. On the other hand, pension insurance funds are against the obligation to cover return losses from their assets and assume risk if the reasons for lower return stem from state problems. The association of the companies suggests that the state also should assume some risk.

**The draft law envisages an increase in the minimum capital required for a pension insurance company** from BGN 3 to 5 million in order to ensure additional guarantees for financial stability. According to the pension insurance companies, this would restrict entry of other companies in the market of pension services, thereby reducing market competition and efficient operation.

The Social Ministry proposed that on coming of retirement age of the insured his/her individual lot be closed and the funds be allocated to a general reserve from which life-long pension will be paid. Upon the pensioner's death the remaining funds shall not be inherited but shall remain in the fund to be paid to longer living persons. According to the pension companies, this is a gross violation of market principles as it involves disposition by the state with the personal funds of the insured. They suggest that before the first pension is determined 7 per cent of the collected amount be set aside to insure against the risk of long living. Upon

the death of the insured person 80 per cent of the remaining amount should go to the heirs and 20 per cent to a reserve fund for longer living pensioners. **As a result of the dispute the present scheme in the SIC remains in force.** Upon the death of the insured person ahead of retirement, his/her heirs should receive the full amount from his/her individual lot. If he/she lives to pension age, his/her lot is preserved and the pension is life-long. Upon the death of the pensioner, his/her heirs receive the residual and the pension company covers the risk of outliving. **The National Social Security Institute (NSSI) suggests a compromise option**, including determination of several types of pension schemes so that persons can choose the one that suits best their needs. In this case healthy pensioners would probably choose life-long pension without inheritance and the sick would preserve their individual lots for a specific term with the inheritance right.

A step towards better protection of the insured persons is made through **regulation of the functions of the custodian bank of a supplementary pension insurance fund**, which will keep all its assets. This new idea of a trustee bank caused serious concern among the banks holding shares in pension companies as the envisaged provision that only one bank may keep the assets of a fund and the ban on relatedness would mean that existing investors would be separated from their companies. It is assumed that the new requirements for a trustee bank would monopolize the market and they expect that only one or several banks would have access to it.

**In addition to pension insurance the draft social insurance code contains a special chapter on supplementary voluntary insurance for unemployment and professional qualification.** The idea is that not only employed persons should insure for unemployment and professional qualification but also free-lance professions and self-insured persons. With the new provisions the government intends to create attractive conditions for the development of this specific insurance business. It is envisaged that

supplementary voluntary insurance for unemployment and professional qualification to be carried out on a fully funded principle with contributions preset in a contract with the insurance company, the funds to be collected both from personal contributions by the insured persons and contributions from their employers.

**At the Round Table on the changes in supplementary pension insurance in mid-September it was announced that as from 2004 there will be a step-by-step increase of the contribution for a second pension for those born after 31st December, 1959.**

It is envisaged that as of 2004 the contribution for the universal pension funds for those born after 31st December, 1959 to be 3.625 per cent and increase gradually to 7.25 per cent in 2010. As a result, one of the requirements of the pension insurance funds, on which they have insisted repeatedly, will be fulfilled. This would make it possible for accumulated funds at universal pension funds to be invested and multiplied, thus encouraging young people's participation in supplementary pension insurance.

## *Supplementary Pension Insurance*

**According to SISA data, as of 30th September, 2002 the total assets managed by the pension insurance companies, voluntary, occupational and universal pension funds amounted to BGN 279,206 thousand**, including BGN 170,630 thousand or 61.11 per cent of the voluntary pension funds, BGN 82,045 thousand or 29.39 per cent of the occupational funds and BGN 26,531 thousand or 9.50 per cent of the universal pension funds. **In the third quarter of the year total assets of pension funds have increased by 16.92 per cent over the second quarter.** Compared to 31st December, 2001, the assets of pension funds have increased by 49.39 per cent.

**As of 30th September, 2002 supplementary pension insurance funds had no investments abroad.**

They invested their assets in securities issued or guaranteed by the state (65.34 per cent), bank deposits in Bulgaria (24.52 per cent), mortgage bonds (4.60

per cent), real property (2.69 per cent), securities listed for trade on regulated securities markets (2.65 per cent), municipal bonds (0.12 per cent), and other investments (0.08 per cent). The assets of pension funds are continuously increasing, making up a huge financial stock that should be invested prudently in the Bulgarian real sector or in foreign securities to ensure higher return for the insured persons and more efficient use of the funds.

**As of 30th September 2002 the total number of the insured at universal, occupational and voluntary pension funds was 1,772,391 persons.**

## *Universal Pension Funds*

**As of 30th September, 2002 the assets of the universal funds amounted to BGN 26,531 thousand, marking an increase of 146.41 per cent in the third quarter.** Their investments comprised mainly securities issued and guaranteed by the state (79.29 per cent), bank deposits in Bulgaria (17.55 per cent) and securities listed for trade on regulated securities markets (3.16 per cent).

**The number of the insured at universal pension funds as of 30th September 2002 was 1,127,399 persons.**

## *Occupational Pension Funds*

**As of 30th September 2002 the assets of occupational pension funds amounted to BGN 82,045 thousand, increasing by 14.80 per cent in the third quarter.** Their investments comprised mainly securities issued and guaranteed by the state (72.39 per cent), bank deposits in Bulgaria (21.92 per cent), and securities listed for trade on regulated securities markets (4.93 per cent) and real property (0.76 per cent).

**The number of the insured at occupational pension funds as of 30th September, 2002 was 153,419 persons.** The number of insured persons at



occupational pension funds working in the conditions of first labor category was 16,514 persons, and those working in the conditions of second labor category numbered 136,905 persons.

### **SISA data show that pension insurance companies continue to restrain from investing abroad.**

The new Social Insurance Code, which is due to come into force in 2003, provides for an increase in the maximum admissible percentage of the assets of the supplementary mandatory pension funds for investments abroad from 10 per cent to 15 per cent of total assets, an insignificant increase in the context of the requirement for minimum 50 per cent of the assets to be invested in government securities.

### *Supplementary Voluntary Pension Insurance*

**As of 30th September, 2002 the assets of the voluntary pension funds amounted to BGN 170,630 thousand, increasing by 8.99 per cent in the third quarter.** The investments of voluntary pension funds comprised mainly securities issued and guaranteed by the state (59.86 per cent), bank deposits in Bulgaria (26.75 per cent), mortgage bonds (7.54 per cent), real property (4.04 per cent), securities listed for trade on regulated securities markets (1.49 per cent), municipal bonds (0.19 per cent) and other investments (0.13 per cent).

**The number of the insured at voluntary pension funds as of 30th September 2002 was 491,573 persons.**

### ***Employment and Unemployment***

**The pilot phase of the National Program "From Social Assistance Towards Employment" was launched in the third quarter of 2002.** It covers 11 municipalities and 5,700 persons. Job opportunities involve mainly community services, public utilities, planting and grassing, social services, maintenance of historic monuments and industry. The Ministry of Labor and Social Policy provided BGN 3.5 million

in total to finance the program which is targeted mainly at municipalities with sizeable unemployment - Ihtiman, Smolian, Kotel, Valchedrum, Satovcha, Chepelare, Madan, Banite - Starazagorsko, Vidin and Belogradchik. Persons employed under the program will receive from BGN 100 to BGN 140 per month in lieu of social benefits and will be insured for retirement, employment accidents and sickness.

A new program of the Ministry of Labor and Social Policy and the Employment Agency was launched in August. It is targeted at graduates of state universities aged up to 29 who face difficulty in finding a job due to lack of work experience. Now they have the chance to apply for 51 jobs within the central administration and 49 within regional municipal administrations. It is expected that the project will expand next year to cover other government institutions - agencies and their regional and territorial units. By 2005 the program will encompass 2,100 young university graduates in total. Graduating students will be employed after winning a competition at the specialized directorates of the public administration under six-month labor contracts.

**Efforts continue under the Program for Micro-Credits through the so-called "Guarantee Fund for Micro-Credits".** Its scope was expanded significantly in the third quarter of the year, easing the terms for obtaining investment and mixed credits of up to BGN 15,000 - for example, lower collateral and reliefs for persons unemployed for more than 1 year, youths up to 29, women and disabled persons. By the end of August 468 projects of borrowers were approved totaling BGN 507,420. This involves creation of 1,107 new jobs and their number is expected to reach 4,000 by the end of the year.

**Expectations are that by the end of the year unemployment will continue to decline in the context of developing and implementing differentiated employment programs.** The optimistic forecast of the Ministry of Labor and Social Policy is for 16.9 per cent unemployment at the end of 2002.



## Income and Living Standards

An **increase in the nominal incomes** of Bulgarians occurred in the third quarter of 2002 both in terms of wages and entrepreneurship, and social benefits. Compared to the same period last year, taking into account the inflation rate, real incomes have increased.

Data from regular NSSI surveys of household budgets for the third quarter of 2002 and national sociological surveys show that the structure of household spending in Bulgaria has changed compared to the same period of last year. Households have spent more on electricity, telephone and water bills at the expense of lower food expenses. At first sight such a trend could indicate higher living standards of Bulgarians but in this case this is due to lower food consumption in order to meet the higher costs in the other groups. Growth in utilities rates even before the beginning of the new heating season is significant both in absolute terms and as a relative share. The growth is due to increased monopoly prices of these services. In August 2002 the prices of postal and railway services were raised as well.

**In this context the issue of further restructuring and privatizing infrastructure sectors at an affordable social cost, given their impact on prices of services and household expenditures, should be accorded serious attention.**

According to data based on sociological agencies' panel surveys, in the third quarter of 2002 household purchases of most product groups remained below or at the levels reported in the same period last year. Growth in cheaper substitutes for the decreasing, more expensive consumption segments sustained.

## Social Partnership

**The pressing questions of industrial relations and social policy remained in the focus of social dialogue even in the typical vacation summer**

**months.**

A major issue of contention that is still being discussed in order to bring positions closer are changes in the Labor Code proposed by the employers' associations. Hard and difficult negotiations between trade unions, employers and the government may be expected and the trade unions could use all legal forms of protest.

Between July and September 2002 the preparation continued for the establishment of a **guarantee fund for employees' receivables in case of insolvency or liquidation of the company**. The general framework of the draft law is ready and the social partners make efforts for the fund to start effectively working at the beginning of 2003. An agreement has been already reached that employees will not participate with initial contributions in the fund. The issues of the amount of liabilities to be covered by the fund, the range of individuals and companies, and the fund management remain unsolved. Apart from this, the Confederation of Independent Trade Unions will insist on changes in the Criminal Code that provide for incrimination of salary non-payment. In addition, the Confederation of Independent Trade Unions proposes that the status of employees be changed on declaring the company bankrupt and that employees receive their salaries before the company makes payments to the National Social Security Institute, banks and suppliers.

In August a number of **amendments to the legal framework were adopted regulating healthy and safe working conditions with a view to converging to the European requirements by 2006**. The objective is to stimulate employers to invest in improving labor conditions and decreasing the number of labor accidents instead of being forced to pay compensations for hard and harmful labor conditions.

Alongside with this, the Council of Ministers adopted the **National Action Plan for Restricting Hard Child Labor**, prepared by the Ministry of Labor and Social Policy. Data from the national survey indicate that about 83,000 children work in the private sector, and 43

per cent of minors work for BGN 10 to 30 per month. Most often child labor is used in trade, services and agriculture. The Action Plan envisages tighter control on economic activities where child labor is involved and fines for the parents who use unlawfully the labor of their children in family business. Another objective of the Plan is to reduce the number of children that do not attend school by supporting families with low incomes and creating conditions for completing secondary education, etc.

**Faltering health care reform led to further deterioration in health care services. The main reasons behind are the shortage of funds at all levels in the health care chain and their inefficient use two years after launch of reform.** This view coincides with the IMF opinion on the health care reform, namely that it is the weak point of the cabinet; therefore more funds should be directed there in 2003. The BGN 131 million funds for medicines of the National Health Insurance Fund (NHIF) for 2002 were depleted in August, many hospitals are practically bankrupt and professional associations insist on an annex to the National Framework Agreement (NFA) to provide additional funds for dental and outpatient specialized services. **Major topics discussed** in the health care field in the third quarter of the year are associated with the draft law on amendment of the Health Insurance Act put forward by the parliamentary fraction of the National Movement Simeon II (NDSV) in mid-July, the annex to the NFA proposed by the professional associations, the proposals tabled by NDSV MPs for changes in the Pharmaceuticals and Pharmacies Serving Human Medicine Act and the draft NHIF budget for 2003.

The minimum capital required for licensing of private health insurance funds is a hotly debated point in the **draft law on amendment of the Health Insurance Act** presented by NDSV. At a first reading in Parliament it was voted that the minimum capital of health insurance companies be reduced from BGN 2 million to BGN 500,000 and the funds be obliged to increase their capital to BGN 2 million in the course of 4 years. This is aimed at increasing the number of licensed private health insurance companies on the market for private health services to enhance competitiveness on the market for health services. NDSV Members of Parliament proposed an additional reduction of the minimum capital from BGN 2 million to BGN 250,000 and the proposal met strong resistance both from NDSV economists and from the licensed health insurance funds. According to the MP presenters of the draft law, operating health insurance companies are interested in preserving the high minimum capital

requirement as in practice it eliminates competition. Health insurance funds, in turn, consider that the proposal on capital reduction would provide opportunity for too many companies to enter the market, some of which may not be in a very stable financial position, whereby commitments of the funds to the insured persons in assuming insurance risks would not be guaranteed. The truth is that reduction of the required statutory capital would increase the number of licensed health insurance companies and enhance market competitiveness but companies like Doverie and Zakrila, which have been already licensed with BGN 2 million capital, will be in an unfavorable position.

**In the middle of September the Bulgarian Doctors Union together with the Union of Dentists lodged a claim with the Supreme Administrative Court against the implicit denial of the Minister of Health to back the annex to the NFA.** Professional organizations and NHIF management were close to signing an annex to provide additional financing in order to ensure sufficient number of examinations in outpatient specialized establishments and slightly cheaper dental activity, but the venture failed due to shortage of funds and absent political will.

**The Association of Medicines Wholesale Traders (AMWT) and the Bulgarian Association of Pharmacists (BAP) insist on adopting the text in the draft law on medicines, which provides for a pharmacy license to be granted to sole proprietors and companies, not to masters-pharmacists, as is the current practice.** According to them, granting privileges for conducting commercial activity on the basis of the educational level collides with the underlying law. The qualification degree should not be decisive in determining who should operate a certain business. The Association of Pharmacists, the Association of Pharmacies and the Branch Chamber of Wholesale Traders in Medicines took the opposite view. They insist for licenses to be granted only to masters-pharmacists to avoid the threat of monopolizing the market. The unsettled issue of the

ownership is definitely in detriment to patients, as it is not clear who is responsible if medicines of poor quality emerge on the market.

**The “Rosche-Bollar rule”, which enables Bulgarian producers to start preparation for registration of generic medicines two years before expiry of the patent protection of original products, was laid down in the law without scandal.** This will enable Bulgarian companies, which produce mainly analogues, to sell them on the market immediately after expiry of the patent of the original products. Bulgarian producers of medicines would be capable of producing new quality generic medicines and compete with other producers of such products, which are already on sale in the EU, and Bulgarian citizens will have access to quality medical products at lower prices.

**Undoubtedly, the most hotly debated issue at the end of the third quarter was the consideration of the 2003 draft budget. One of the major issues of discord on the 2003 budget was health policy. Initially the Minister of Healthcare demanded 6 per cent of GDP for health care and then pleaded for 4.3 per cent.** The Finance Ministry on its part has budgeted expenditures for health care at 3.9 per cent of GDP. In absolute terms funds for health care, as provided in the 2003 draft budget, are expected to grow in view of the expected GDP growth, but given the current deficiency of funds in the health insurance fund, budgeted funds for the health sector are insufficient.

The intention of the Government is to reduce health care subsidies to municipalities in 2003 and preserve funding from the Health Ministry at the 2002 level. As a result, the Health Insurance Fund would receive additional funds for financing of the hospital sector. The objective of the Government is for the medical establishments to receive money for work done (as NHIF pays), not general budget subsidy, with a view to the more efficient use of funds for health care. The problem with hospital services is very serious, given

accumulated payables of hospitals totaling more than BGN 90 million and the fact that the hospitals are amortized, the equipment is outdated, and the structure unchanged. By expert estimates, the number of hospitals should be reduced to 140, but 2 years after launch of reform the number of hospitals stays the same, i.e. about 300.

**According to the IMF, however, reducing the budget subsidy for health care is not realistic, as the structural reform in the sector has been blocked in practice.** There are no indications that more radical steps would be taken, as the Health Ministry seeks ways to finance the shortage of funds in the hospital system instead of downsizing it.

**Discussions on the NHIF budget for 2003 continued in the last quarter of the year. Whether funds for health care in 2003 will be increased, how to distribute the funds between NHIF, the Ministry of Health and municipalities and whether they will be used efficiently is a matter of political will.**

Health care problems give grounds for reflection on the future of the health sector. One of the publicly discussed scenarios for the development of health insurance is to introduce mandatory minimum contribution to the NHIF, which will perform only social functions, and to set up private health insurance funds, which are expected to build their structures in such a way as to optimize costs and preclude any possibility of abuse. **However, the political will needed to outline clear and decisive further steps in health reform is missing.**

In the third quarter of 2002 environmental legislation focused public attention for several reasons - the National Assembly adopted two of the most important acts in the Bulgarian environmental law and the two acts were remitted to the National Assembly for reconsideration through President veto.

**The draft of the Biological Diversity Act** presented by the Council of Ministers is aimed at regulating a whole set of public relations which lacked specific legal treatment. The term "biological diversity" is defined as part of the national wealth. Alongside with regulating the activities on protection of biological species, the Act specifies more precisely customs requirements and the terms of trade, providing for a comparatively clear separation of the responsibilities of the subjects of these relations.

**The motives of the President for reconsideration of the Act<sup>15</sup>** by the National Assembly reflected doubts that its provisions are anti-constitutional. Disagreement with the proposed provisions can be summarized in several directions:

- The Biological Diversity Act is in unconformity to the Environment Protection Act in view of the role and the cases of application of the procedure for EIA (environmental impact assessment) as it introduces a subsidiary procedure - environmental assessment - and the procedure for implementing such assessment is not clearly defined in the new Act.
- Consistency between the Environment Protection Act and the new Biological Diversity Act is broken, as the new Act does not preserve principles and ideas, which are still valid. Expanding the powers of the Minister of the Environment and Water regarding management of protected territories leads to unreasonable expansion of the powers of the executive branch and narrows, instead of improving, the legal framework of national parks and reserves.

- The provisions of the Biological Diversity Act represent a dramatic departure from the basic "polluter pays" environmental principle as they abolish major financial sanctions applied so far (the charge "Nature" for properties located in protected territories). Therefore they collide with the existing constitutional principle, which stipulates that protection of environment and nature is a major responsibility of every citizen.

After second consideration by the Parliament the Biological Diversity Act was adopted in the format presented by the Government.

Public expectations throughout 2002 were that the **new Environment Protection Act** will further develop in Bulgaria the standards in this area and will establish the legal framework to guarantee to a maximum extent major rights of the citizens to favorable and healthy environment. Expectations reflected on a demanding public approach to this statutory instrument as it is underlying the future environmental policy. The provisions of the Act came under severe criticism from non-government organizations<sup>16</sup> and experts and its sending back for reconsideration by Parliament as a result of the **President veto** was a sign that something very serious in the philosophy of the Act causes concern.

The Environment Protection Act was adopted by the Parliament even after the President veto. It introduces important European directives, including on guaranteeing the rights of citizens to environmental information. Experts' criticism on this point stems from the fear that the Act does not ensure sufficient guarantee that "the public will be permanently informed on the condition of the environment"<sup>17</sup> as it does not provide for the obligation of the state to ensure proper conditions for access to information.

Other grounds for criticism against the provisions of the new Environment Protection Act involve the areas of application of two major environmental policy instruments: the procedures for environmental

<sup>15</sup> Motives for remitting the Biological Diversity Act for reconsideration, Official Gazette, issue 72.

<sup>16</sup> IME opinion on the draft Environment Protection Act, [www.ime-bg.org](http://www.ime-bg.org)

<sup>17</sup> Motives for remitting the Environment Protection Act for reconsideration, Official Gazette, issue 76, 06.08.2002.



assessment and for environmental impact assessment. Their application is reduced only to investment proposals and they do not apply to national security plans and programs and big polluters. According to experts, several facts create conditions for the stable legal framework in the field of environmental law to be replaced with regulations of lower level. The new Act mandates a right to the Minister to exempt investment proposals from mandatory EIA. At the same time, the Minister of the Environment and Water has the right, by virtue of the same Act, to regulate through ordinances the procedure for conducting EIA on national, regional and district plans until the new legal procedure - environmental assessment - comes into force (from 1st July, 2004).

In addition, non-government organizations and experts criticized the general philosophy of the Act as it allows replacement of market principles with administrative regulation of environment protection activities and it was adopted without constructive preliminary discussions with representatives from different social layers, the business community in particular.

The hot public debate on the two environmental acts was unjustifiably qualified as "war of institutions". Formally the ground for this qualification was the official statement by the Ministry of the Environment and Water in which the arguments of the presidential institution were qualified as "demonstration of lack of understanding and knowledge of the provisions of the European law."

Our understanding is that the issue of the access to environment information and public involvement in environment-related decision-making is of crucial importance to modern forms of state policy in the field. Under the conditions of market economy and free entrepreneurship investment decisions that have a direct impact on the environment should be made primarily by the corporate sector. The legally mandated right to information for the citizens and clear procedures for public participation in the early stages of investment project development will allow

a broad range of interested social layers to take effective part in management decisions and exercise control on factors of vital importance to the social and natural environment. In this context, the debate on the national environmental legislation necessitates careful consideration of all opinions and demonstration of maturity and skills for conducting a constructive dialogue at all stages of the legislative process.

Table 9.

Monitoring of Negotiations for Bulgaria's Accession to EU

| Chapter                               | Status                                   |
|---------------------------------------|--|
|                                       | 30th September 2002 (30th November 2002) |
| 1 Free Movement of Goods              | Provisionally closed                     |
| 2 Free Movement of Persons            | Provisionally closed                     |
| 3 Freedom to Provide Services         | Provisionally closed                     |
| 4 Free Movement of Capital            | Provisionally closed                     |
| 5 Company Law                         | Provisionally closed                     |
| 6 Competition Policy                  | Open                                     |
| 7 Agriculture                         | Open                                     |
| 8 Fishery                             | Provisionally closed                     |
| 9 Transport Policy                    | Open                                     |
| 10 Tax Policy                         | Provisionally closed                     |
| 11 Economic and Monetary Union        | Provisionally closed                     |
| 12 Statistics                         | Provisionally closed                     |
| 13 Social Policy                      | Provisionally closed                     |
| 14 Energy                             | Open (provisionally closed)              |
| 15 Industrial Policy                  | Provisionally closed                     |
| 16 Small and Medium-Sized Enterprises | Provisionally closed                     |
| 17 Science and Research               | Provisionally closed                     |
| 18 Education and Training             | Provisionally closed                     |
| 19 Telecommunications                 | Provisionally closed                     |
| 20 Culture and Audiovision            | Provisionally closed                     |
| 21 Regional Policy                    | Open                                     |
| 22 Environment                        | Open                                     |
| 23 Consumer Protection                | Provisionally closed                     |
| 24 Justice and Home Affairs           | Open                                     |
| 25 Customs Union                      | Provisionally closed                     |
| 26 Foreign Relations                  | Provisionally closed                     |
| 27 Common Foreign and Security Policy | Provisionally closed                     |
| 28 Fiscal Control                     | Open (provisionally closed)              |
| 29 Fiscal and Budgetary Issues        | Open                                     |
| 30 Institutions                       | Provisionally closed                     |
| <b>Total chapters closed</b>          | <b>21 (23)</b>                           |

Bulgaria continued to actively implement its Strategy of Accelerated Negotiations for Accession to the European Union. Meglena Kouneva, Minister of European Affairs underlined that "Bulgaria's strat-

egy of negotiations was based on the belief in the interrelated integration of EU Acquis Communautaire into national legislation and strengthening of the administrative capacity for its application".

**During a two-day meeting on EU enlargement held in Brussels on 30th July 2002, Bulgaria completed negotiations on Chapter 25: Customs Union, whereby it definitely committed to ensure a transparent and efficient customs service.** Bulgaria guarantees institutional capacity for customs control and efficient implementation of the *acquis communautaire* in the Customs Union area.

With Chapter 25 "Customs Union", the provisionally closed chapters make twenty-one as of the end of September. Later, negotiations on Chapter 28: Fiscal Control, were successfully completed at the Seventh Session of the Conference on Negotiations for Accession in Brussels.

With a view to guarantee uniform and coordinated policy in the relations with the European Union, the Government adopted on 15th August, 2002, a **Decree amending the Rules of Procedure of the Ministry of Foreign Affairs and the Decree on the Organization and Coordination of Bulgaria's Preparation for Accession to the European Union and on Holding the Negotiations for Accession.** Amendments define the functions of the Minister of European Affairs and regulate minister's relationship with the other government authorities. The Minister of European Affairs shall ensure implementation of uniform and coordinated policy on all aspects of our relations with the European Union.

The Minister of European Affairs shall introduce in the Council of Ministers, conjointly with the Minister of Foreign Affairs, draft resolutions on issues related to EU accession, including proposals of the Council on European Integration. The minister shall coordinate the specific implementation of agreements with EU. The Minister of European Affairs shall participate in the Council on European Integration; approve the heads and members of delegations for individual sectors of the dialogue with the European Union; and propose to the Prime Minister for approval the heads of working groups for negotiations. The minister shall prepare the final draft of the National

Program on Adoption of the *Acquis Communautaire* of the European Communities and shall coordinate the correspondence of individual ministries with EU institutions and Bulgaria's Mission at the European Communities in Brussels.

The Minister of European Affairs and Chief Negotiator with the European Union shall coordinate the operational management of the Directorate of European Integration at the Ministry of Foreign Affairs; control and harmonize the work of Directorates of European Integration at other ministries.

The Minister of Foreign Affairs shall be the head of the Delegation for Negotiations with the European Union. He shall present Bulgaria's final position on the negotiation chapters; control the specific implementation of agreements; and participate in utilizing the aid granted by the European Union.

At the end of August 2002, the Government approved and adopted a **Pre-Accession Economic Program (2002-2005)**. It has been developed in accordance with the specific recommendations of the European Commission, adopted at the Madrid Summit of the Members of the Council of Member States Economic and Financial Ministers on 26th March 2002. **The basic objective of Bulgaria's economic policy in the period till 2002 will be to raise the standard of living and narrow the gap between the average income in the country and in the European Union. A major priority set forth in the program is to complete negotiations for accession to the European Union by the end of 2003, and full membership as of January 2007.**

At the end of July, 2002, the Council of Ministers approved **Bulgaria's participation in the MEDIA Plus and MEDIA - Training programs for the period 2000-2005.** The Government appointed the Ministry of Culture, the National Film Center in particular, a national coordinator of the programs.

MEDIA Plus and MEDIA - Training are EU programs

for support of the European audiovision sector. They focus on providing more opportunities to finance package projects for distribution of European products with a view to support market structuring, as well as pilot projects in the field of new technologies. Programs involve four basic elements: training of specialists; development of cinema projects; distribution of European cinema and audio-video products. Accession to the two programs will enable Bulgarian professionals to work in partnership and compete on equal terms with their colleagues from the other EU Member States.

Given the high level of harmonization of national media legislation with European standards, Bulgaria was the only candidate country that participated in the MEDIA II program completed at the end of 2000. In September 2001, the European Commission officially invited Bulgaria and some other candidate countries to join the MEDIA Plus and MEDIA-Training programs for the period 2002 – 2005. In December 2001, the Bulgarian State officially confirmed its willingness to participate in these programs.

In mid September, 2002, the Government **approved Bulgaria's participation in three other programs of the European Community in the field of employment and social policy** - EC Program for Gender Equality (2001-2005), EC Anti-Discrimination Program (2001-2006), EC Program to Fight Social Inequality (2002 -2006).

The three programs envisage seminars, conferences, meetings to exchange experience, creating databases, research, contacts between institutions and organizations from different countries and at supranational level. Program coordinators are the Ministry of Labor and Social Policy and the National Council on Ethnic and Demographic Matters at the Council of Ministers. A portion of the funds for Bulgaria's participation are provided under the PHARE Program.

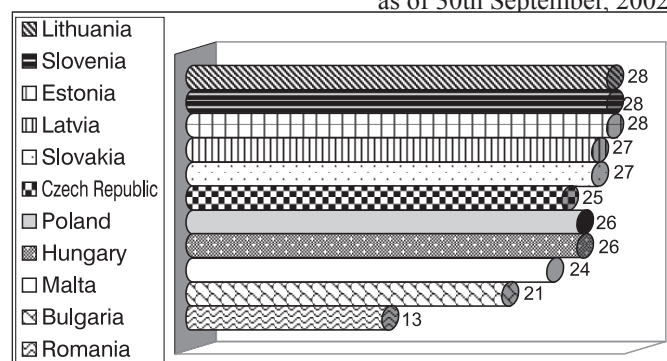
On 24th September, 2002, Meglena Kouneva, Minister of European Affairs and Milko Kovachev, Minister

of Energy and Energy Resources announced **Bulgaria's new position on Kozloduy NPP**. The country accepts the EU requirement to close down units 3 и 4, but insists on expert assessment of the condition of reactors. In the meantime the National Assembly stood by the idea that the units should not be closed before Bulgaria's accession to the European Union.

In November 2002, the European Union accepted the position of the Bulgarian Government and Chapter 14: Energy, was provisionally closed. Thus negotiations for accession will continue at the same pace.

The Danish Minister of Foreign Affairs Per Stig Moeler indicated at a meeting in Brussels that the road map for Bulgaria to be adopted by the European Council in Copenhagen will allow to keep the pace of negotiations. A special package will be adopted to that effect. It will accelerate Bulgaria's accession. The statement of Guenter Ferheugen, European Commissioner on Enlargement that the European Commission will recommend in its 2002 Regular Report full support for Bulgaria's membership, and that the country's equal treatment will be a major priority of recommendations, also sounds optimistic. The overall assessment of the negotiation process reveals that 11 of the 12 candidate countries, including Bulgaria, have opened all chapters for negotiation. Bulgaria is in the group of countries (including the Czech Republic, Hungary, Latvia, and Slovakia) which have closed 21 to 27 chapters (Figure 19).

Figure 19. Provisionally Closed Chapters of Negotiations for Accession (by candidate countries, as of 30th September, 2002)



## Public Procurement

Following the amendments adopted in spring, **new changes in the Public Procurement Act are pending**. A special working group was set up with the Council of Ministers to draft the amendments. The major problem that needs to be resolved involves appeal of procedures. At present an unsuccessful candidate for contracting a public order may appeal the procedure in court and this precludes the possibility of signing a contract with the selected company before a court ruling, which takes months. Changes aim for the contracts to be closed irrespective of the appeals lodged by unsuccessful candidates and the appeals to be considered afterwards. The procedure for appeal is a point on which Bulgaria is criticized by the EC. Probably this case will be difficult to resolve. Currently the European experience in this field is being studied.

In addition, the changes are expected to alleviate the public procurement regime for the companies in the utilities sector. In the context of EC requirements all orders need be assigned codes compatible with those introduced in the EU. The issue of introducing preferences for Bulgarian contractors will be raised again (currently a Regulation is being drafted, which provides for such preferences, but it has not been adopted yet).

## Licensing Regimes

The decision passed by the Government based on the recommendations of the special working group envisaged abolition of 74 regimes and alleviation of 118 regimes. Specific draft laws, by-laws and other statutory changes should have followed the decision. Unfortunately, the proposals for genuine reform in the licensing regime area are few, i.e. the actual reduction of regimes is progressing slowly. At the same time, new regimes are being introduced under pretext of compliance with the requirements of harmonizing Bulgarian legislation with the EU.

The recommendations of the special working group envisaged the establishment of a **system for information exchange from the databases of different government agencies** for the purpose of license issuing and control, as well as submitting lists of statutory instruments regulating regime-related database creation and maintenance. The proposals aimed at saving time and funds for considering license applications. Work on implementing the decisions has been delayed.

Some of the enacted statutory changes in compliance with the Government's decision are:

- The registration regime for import of non-bottled strong alcoholic drinks, ethyl alcohol and complex alcoholic ingredients used in the production of beverages is abolished;
- The permit regime for re-export of endangered flora and fauna species, included in the Washington Convention on International Trade in Endangered Wild Flora and Fauna Species, is abolished.

The problem with license regimes has not been radically resolved in the system - currently an individual approach is being applied, post factum analyzing existing regimes and seeking ways to modify them.

An IME team with participants from the Bulgarian Industrial Association, the Bulgarian Chamber of Commerce and Industry, and ASME suggested another approach. It provides for developing general principles in the implementation of administrative procedures and compliance of effective and future regimes with these general principles. This approach led to the preparation of a **draft law on Legislative Acts and Administrative Procedure** on economic activity. The Government has already approved the draft. The **advantage** of this law is that it will provide a general framework of the relationships between businessmen and central administration and local administrations regarding start-up, conduct and termination of business. The **possible effects** from such approach could be improved business environment - creating a



more transparent environment for business, reducing the number of regimes, general criteria for introducing new regimes, a barrier to complicating regimes, cutting implementation costs, etc.

### State Aid

In August Regulation No. 6 was adopted on the Procedure for Monitoring and Ensuring Transparency on State Aid (the Regulation is in implementation of the State Aid Act adopted in March 2002, effective as of 20th June, 2002). The Regulation adds to the package of statutory instruments (an act, rules of procedure, promulgated in June, and a regulation) treating the regulation and control of state aid granting and monitoring of aid spending.

### Protection of Competition

In September the Council of Ministers approved a **draft on amendments to the Act on Protection of Competition (APC)**. The draft was adopted at first reading by Parliament (the second reading of the draft will begin in October). The changes aim at introducing strict rules against cartels and tighter control on companies with monopoly market position. Timely adoption of the proposed changes is one of the conditions for closing Chapter "Competition Policies" in the negotiations with the EU. Specifically, the amendments treat the following issues:

- Agreements within associations of companies are prohibited. This means that associations of branch industries will not have the right to make internal decisions on setting common prices and market distribution;
- The threshold for the so-called "agreements with insignificant effect" is made more precise;
- The term collective dominance abuse is introduced (actions of two or more companies with joint monopoly position are prohibited);
- Companies operating on the same market and planning to merge are obliged to obtain authorization from the CPC if their joint turnover exceeds BGN 1.5 million.

The powers of the Commission for Protection of Competition are expanded. The Commission is mandated powers to rule on the separation of newly emerged enterprises or associations if they have been formed in violation of the Act. The Commission may overrule established purchase prices and illegal cartels. The Commission is mandated the right to enforce gathering of evidence with court permission - a circumstance which poses a threat of racketeering and political pressure.

Discussion of the proposals was coupled with serious debate, mainly on the composition of the Commission for Protection of Competition and the manner of appointing its members. A point of discord is the expanded powers of the Commission, whose term expires on 10th December, 2002.

### Regulation of Bankruptcy Procedures

Work on drafting amendments to the Commercial Code in the section on bankruptcy and liquidation continued. This is one of the major measures included in the package for boosting economic growth, proposed as late as October by Nikolay Vasilev, Deputy Prime Minister and Minister of Economy. The proposed changes aim at accelerating bankruptcy procedures, reducing the terms for their execution, and better protection of the interests of bona fide creditors. The following changes are envisaged:

- Insolvency is considered to be in place not only when the debtor has stopped making payments but also in the cases when he has not met an obligation on a deal within 60 days from the date of its ascertainment or when he has failed to meet a public legal obligation established by virtue of an effective act. A possibility is being discussed to adopt the US law practice, under which in the event of a collective claim lodged by more than three creditors, a debtor is directly considered bankrupt.
- Elaborating the bankruptcy procedures. The Code will lay down the complete procedure for cashing property.
- New requirements to receivers are introduced,

which shall be legal entities.

- Mala fide creditors pursuing simulated suits will be penalized.

Discussion of the proposed amendments in Parliament is pending.

### **The Judiciary System and Combating Corruption**

In September supreme judges instituted proceedings at the Constitutional Court against the proposed and adopted by Parliament amendments to the Judiciary System Act, as it would delay judiciary system reform. The amendments to the Act aim to provide transparency on the work of the judiciary system. The provisions attacked by the Supreme Judicial Council are the following:

- The 5-year term of office for judiciary officials;
- The possibility for their election after voting of the general meetings of relevant judiciary structures;
- The right of the Minister of Justice to table proposals for appointment and sanctions on the Supreme Judicial Council;
- The right of the Ministry of Justice inspectors to examine senior judiciary, prosecution and investigation units.

The monopoly power of the General Prosecutor to require lifting of the immunity of magistrates is abolished and such a proposal may be put forward also by one-fifth of the members of the judiciary council. The Supreme Judicial Council attacks namely these points with the motive that the Constitution is breached.

The magistrates declared they would not participate in the working groups responsible for drafting the regulations necessary for the implementation of the amendments to the Judiciary System Act. Such a behavior could confirm the EC finding on unclear distribution of roles and responsibilities between the Supreme Judicial Council and the Ministry of Justice, a factor for the inefficient functioning of the judiciary system.

In the beginning of September the Parliament passed a resolution on establishing a Commission on Combating Corruption. After debates on the form and status of the Commission (sub commission or parliamentary commission) the decision was in favor of the more authoritative structure.

### **Administrative Reform and Support for Business**

In the middle of the year the Government adopted a "Strategy for Public Administration Modernization from Accession to Integration", together with a plan for its implementation. The main objective of the Strategy is to encourage stronger public administration responsibility. This is yet another strategy aimed at improving the efficient work of public administration. It is difficult to tell whether it will achieve the desired effect as the strategy itself has deficiencies - inconsistent structure and measures, unclear points regarding the status of civil servants (hiring, firing, etc.).

In order to support business, an electronic business center at the Agency for Promoting Trade (APT) launched operation, a result of the cooperation between APT and the Greek Organization for Foreign Trade (HEPO). The purpose of the center is to facilitate business contacts between Bulgarian companies and foreign partners. The project is part of a five-year program funded by the Greek government under the PHARE Program.

# ANNEX 1: MAIN INDICATORS FOR THE THIRD QUARTER OF 2002

| Main indicators for the third quarter of 2002  |       |       |       |       |       |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Economic dynamics  |       |       |       |       |       |       |       |       |       |       |       |       |
| Industry   | I     | II    | III   | IV    | V     | VI    | VII   | VIII  | IX    | X     | XI    | XII   |
|  |       |       |       |       |       |       |       |       |       |       |       |       |
| Industrial production, volume index, previous month =100, %  |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 86.5  | 118.8 | 114.9 | 104.5 | 99.1  | 104.2 | 106.3 | 97.2  | 108.4 |       |       |       |
| 2001   | 79.3  | 110.5 | 111.1 | 89.9  | 103.6 | 106.3 | 103.6 | 105.3 | 101.9 | 106.2 | 106.6 | 106.5 |
| Industrial production, volume index, corresponding month of the previous year = 100, %   |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 97.1  | 100.1 | 97.5  | 115.5 | 105.3 | 103   | 108.5 | 106   | 106.7 |       |       |       |
| 2001   | 93.5  | 128   | 102.1 | 101.6 | 104   | 100.2 | 106.8 | 110.3 | 102.7 | 99.3  | 101.3 | 95    |
| Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %                                  |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 97.1  | 97.3  | 96.9  | 101.3 | 102.1 | 101.5 | 102.8 | 103.8 | 103.9 |       |       |       |
| 2001   | 93.5  | 111.9 | 102.5 | 103   | 102.4 | 101.7 | 102   | 102.6 | 102.2 | 101.5 | 102.4 | 100.7 |
| Industrial sales, total, volume index, previous month =100, %  |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 84    | 99.6  | 110   | 109.3 | 92.8  | 108.5 | 106.3 | 94.4  | 101.7 |       |       |       |
| 2001   | 80    | 103.5 | 105.4 | 90.3  | 105.4 | 100.5 | 101.7 | 99.8  | 97.1  | 106.8 | 97.6  | 101.9 |
| Industrial sales, total, corresponding month of the previous year = 100, %   |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 91.8  | 88    | 89.1  | 106.3 | 94.3  | 100.1 | 107.3 | 102.6 | 105.4 |       |       |       |
| 2001   | 112.8 | 105.7 | 99.8  | 104.3 | 103.9 | 97.4  | 102.3 | 99.1  | 95.4  | 96.7  | 92.8  | 92.7  |
| Industrial sales, total, A43, volume index, corresponding period of the previous year = 100, %   |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 91.8  | 90.3  | 89.4  | 93.8  | 94    | 94.5  | 96.9  | 97.6  | 98.7  |       |       |       |
| 2001   | 112.8 | 109.2 | 104.9 | 104.6 | 104.4 | 103.1 | 103.2 | 102.8 | 101.9 | 101.2 | 100.6 | 99.4  |
| Trade and repairing activities, total, net receipts from sales, volume index, previous month =100, %   |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | -     | 113.3 | 111.7 | 98.9  | 98.2  | 101.6 | 111.6 | 102.4 | 101.4 |       |       |       |
| 2001   | -     | 101.7 | 118.3 | 90.3  | 103.3 | 99.2  | 111.2 | 100.9 | 90.7  | 102.7 | 95.3  | 115.4 |
| Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, previous month =100, % |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | -     | 99.7  | 116.9 | 95.4  | 99.6  | 107.7 | 106.7 | 97    | 102.7 |       |       |       |
| 2001   | -     | 91.9  | 125.6 | 87.8  | 107.3 | 104.8 | 102.7 | 104.2 | 90.3  | 99.0  | 97.9  | 118.2 |
| Wholesale and commission trade, net receipts from sales, volume index, previous month =100, %  |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | -     | 118.3 | 112   | 99.1  | 97.3  | 100.5 | 113.7 | 103   | 100.9 |       |       |       |
| 2001   | -     | 104.2 | 119.8 | 89    | 101.6 | 98.4  | 114.9 | 99.6  | 88.8  | 104.3 | 94.1  | 114.8 |
| Retail trade, repair of personal and household goods, net receipts from sales, volume index, previous month =100, %                                      |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | -     | 100.8 | 106.4 | 100.1 | 101.7 | 102.6 | 105.1 | 103.3 | 102.9 |       |       |       |
| 2001   | -     | 98.1  | 108   | 97.7  | 108.3 | 98.5  | 101.8 | 104.8 | 99    | 98.7  | 98.6  | 115.9 |
| Trade and repairing activities, total, net receipts from sales, volume index, corresponding month of the previous year = 100, %                          |       |       |       |       |       |       |       |       |       |       |       |       |
| 2002   | 93.1  | 100.1 | 97.9  | 103   | 100.1 | 101.9 | 106.6 | 108.9 | 110.6 |       |       |       |
| 2001   | 95.1  | 99.2  | 101.1 | 102.7 | 105.4 | 100.3 | 102   | 102.4 | 95.9  | 95.6  | 96.4  | 98.8  |

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| Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, corresponding month of the previous year = 100, %                                 |         |         |         |         |         |         |         |         |         |         |         |        |        |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--------|--------|
| 2002  | 97.3    | 106.7   | 103.1   | 103.1   | 98.4    | 98.5    | 98.7    | 98.9    | 101.4   |         | -       | -      | -      |
| 2001  | 99.4    | 90.1    | 100.3   | 102.9   | 107.7   | 110.8   | 109.3   | 107.5   | 107.1   | 104.8   | 101.8   | -      | -      |
| Wholesale and commission trade, net receipts from sales, volume index, corresponding month of the previous year = 100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 90.9    | 98.7    | 96.4    | 103.2   | 100.3   | 102.6   | 108.3   | 110.9   | 113.5   |         | -       | -      | -      |
| 2001  | 92.0    | 100.2   | 101.4   | 102.1   | 104.6   | 98.3    | 99.8    | 100.4   | 92.4    | 93.7    | 97.2    | -      | -      |
| Retail trade, repair of personal and household goods, net receipts from sales, volume index, corresponding month of the previous year = 100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 101     | 103.4   | 101.6   | 101.9   | 100.2   | 101.1   | 104.5   | 106.2   | 104.1   |         | -       | -      | -      |
| 2001  | 107.8   | 101.0   | 100.7   | 105     | 107.2   | 101.7   | 107.7   | 107.8   | 104.7   | 103.1   | 103.5   | 103    | -      |
| Trade and repairing activities, total, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %   |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 93.1    | 96.7    | 95.4    | 97.3    | 97.9    | 98.5    | 99.8    | 101     | 102.1   |         | -       | -      | -      |
| 2001  | 95.1    | 96.6    | 98.2    | 101     | 101.9   | 101.6   | 101.6   | 101.7   | 101     | 100.6   | 100.2   | 100.1  | -      |
| Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, % |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 97.3    | 101.8   | 102.3   | 102.5   | 101.6   | 101     | 100.7   | 100.4   | 100.5   |         | -       | -      | -      |
| 2001  | 99.4    | 94.8    | 96.8    | 98.6    | 100.4   | 102.2   | 103.1   | 103.7   | 104.1   | 103.3   | 103.5   | 103.3  | -      |
| Wholesale and commission trade, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 90.9    | 94.9    | 93.2    | 95.7    | 96.6    | 97.6    | 99.2    | 100.7   | 102.2   |         | -       | -      | -      |
| 2001  | 92.0    | 95.1    | 97.5    | 100.7   | 101.5   | 100.9   | 100.7   | 100.6   | 99.7    | 99.1    | 98.6    | 98.5   | -      |
| Retail trade, repair of personal and household goods, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %                                      |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 101     | 102.3   | 102.1   | 102.1   | 101.7   | 101.6   | 102     | 102.6   | 102.8   |         | -       | -      | -      |
| 2001  | 107.8   | 104.3   | 102.8   | 103.9   | 104.7   | 104.1   | 104.6   | 105.1   | 105.1   | 105.3   | 105.1   | 104.9  | -      |
| Inflation   |         |         |         |         |         |         |         |         |         |         |         |        |        |
| Inflation (Consumer price index - 100), previous month =100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 2.7     | 1.6     | 0.8     | -0.1    | -2.1    | -1.7    | 0.1     | -0.7    | 0.8     | 1.0     |         | -      | -      |
| 2001  | 0.6     | 0.3     | 0.1     | -0.2    | 0.1     | -0.1    | -0.2    | 0.3     | 1.3     | 1.7     | 0.2     | 0.6    | -      |
| Inflation (Consumer price index - 100), December of the previous year = 100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 2.7     | 4.4     | 5.2     | 5.1     | 2.9     | 1.1     | 1.2     | 0.6     | 1.4     | 2.4     |         | -      | -      |
| 2001  | 0.6     | 1.0     | 1.0     | 0.8     | 0.9     | 0.8     | 0.6     | 0.9     | 2.2     | 4.0     | 4.2     | 4.8    | -      |
| Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 7.0     | 8.4     | 9.2     | 9.2     | 6.9     | 5.2     | 5.5     | 4.5     | 4.0     | 3.2     |         | 8.2    | 7.1    |
| 2001  | 9.3     | 8.5     | 8.9     | 9.8     | 9.7     | 9.4     | 8.5     | 5.7     | 4.7     | 5.2     | 4.6     | 4.8    | 9.6    |
| 6.3   |         |         |         |         |         |         |         |         |         |         |         |        |        |
| Employment and unemployment   |         |         |         |         |         |         |         |         |         |         |         |        |        |
| Unemployed persons registered, total, end of the period, number   |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 687 805 | 683 894 | 668 972 | 678 637 | 673 803 | 659 032 | 653 329 | 650 018 | 644 718 | 644 298 |         | 668972 | 659032 |
| 2001  | 708 729 | 713 761 | 704 691 | 707 793 | 678 528 | 654 008 | 643 528 | 637 831 | 629 866 | 637 348 | 662 260 | 704691 | 654008 |
| Unemployment (Employment Agency, ratio to the economically active population from the population census in 1992), end of the period, %  |         |         |         |         |         |         |         |         |         |         |         |        |        |
| 2002  | 17.99   | 17.89   | 17.5    | 17.75   | 17.63   | 17.24   | 17.09   | 17.00   | 16.86   | 16.85   |         | 17.50  | 17.24  |
| 2001  | 18.54   | 18.67   | 18.43   | 18.51   | 17.75   | 17.11   | 16.83   | 16.68   | 16.48   | 16.67   | 17.18   | 17.32  | 17.11  |
| 16.48   |         |         |         |         |         |         |         |         |         |         |         |        |        |

# ANNEX 1: MAIN INDICATORS FOR THE THIRD QUARTER OF 2002

| Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, % |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|---------|
| 2002   | 18.57     | 18.46     | 18.06     | 18.32     | 18.19     | 17.79     | 17.64     | 17.55     | 17.4      | 17.39     |           | 18.06     | 17.79     | 17.4      |         |
| 2001   | 19.13     | 19.27     | 19.02     | 19.11     | 18.32     | 17.66     | 17.37     | 17.22     | 17        | 17.21     | 17.74     | 17.88     | 17.66     | 17.00     |         |
| Newly opened vacant jobs, end of the period, number  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 1 588     | 4 177     | 3 284     | 3 420     | 2 437     | 2 055     | 2 011     | 3 272     | 2 802     | 2 270     |           | 3 284     | 2 055     | 2 802     |         |
| 2001   | 2 587     | 2 908     | 3 903     | 2 287     | 3 732     | 4 236     | 2 210     | 2 170     | 2 246     | 2 212     | 1 268     | 3 903     | 4 236     | 2 246     |         |
| Employed person, total, average for the period, number   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 1 878 628 | 1 883 392 | 1 890 173 | 1 895 911 | 1 905 823 | 1 913 121 | 1 917 999 | 1 914 477 | 1 925 092 |           |           | 1 884 064 | 1 904 952 | 1 919 189 |         |
| 2001   | 1 851 914 | 1 854 770 | 1 866 572 | 1 881 996 | 1 904 129 | 1 916 922 | 1 901 499 | 1 890 120 | 1 896 077 | 1 912 239 | 1 878 849 | 1 857 752 | 1 901 016 | 1 895 899 |         |
| Employed person, public sector, average for the period, number   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 761 630   | 762 192   | 760 562   | 749 826   | 745 729   | 743 092   | 737 200   | 735 424   | 740 543   |           |           | 761 461   | 746 216   | 737 722   |         |
| 2001   | 803 322   | 804 038   | 802 894   | 782 409   | 781 331   | 778 545   | 770 832   | 765 341   | 767 022   | 766 079   | 768 207   | 803 418   | 780 762   | 767 732   |         |
| Employed person, private sector, average for the period, number  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 1 116 998 | 1 121 200 | 1 129 611 | 1 146 085 | 1 160 094 | 1 170 029 | 1 180 799 | 1 179 053 | 1 184 549 |           |           | 1 122 603 | 1 158 736 | 1 181 467 |         |
| 2001   | 1 048 592 | 1 050 732 | 1 063 678 | 1 099 587 | 1 122 798 | 1 138 377 | 1 130 667 | 1 124 779 | 1 129 055 | 1 146 160 | 1 134 365 | 1 110 642 | 1 120 254 | 1 128 167 |         |
| Fiscal review  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| State budget   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
|  | I         | I-II      | I-III     | I-IV      | I-V       | I-VI      | I-VII     | I-VIII    | I-IX      | I-X       | I-XI      | I-XII     | Q1        | Q2        | Q3      |
| Revenues of the Consolidated State Budget, total, BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 889.1     | 1 752.7   | 2 782.3   | 4 040.8   | 5 156.1   | 6 064.4   | 7 247.7   | 8 194.7   | -         |           |           |           | 2 782.3   | 3 282.1   |         |
| 2001   | 852.2     | 1 605.4   | 2 775.9   | 4 017.6   | 5 107.0   | 6 062.1   | 7 066.5   | 7 897.7   | 8 705.3   | 9 708.8   | 10 617.7  | 11 837.9  | 2 775.9   | 3 286.2   | 2 643.2 |
| Expenditures of the Consolidated State Budget, total, BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 1 020.3   | 1 905.9   | 2 821.1   | 3 928.6   | 4 816.5   | 5 733.6   | 6 843.6   | 7 778     | -         |           |           |           | 2 821.1   | 2 912.5   |         |
| 2001   | 1 091.8   | 1 968.8   | 2 897.2   | 3 901.0   | 4 888.5   | 5 895.1   | 7 116.1   | 7 979.0   | 8 846.9   | 9 709.1   | 10 620.7  | 12 093.1  | 2 897.2   | 2 997.9   | 2 951.8 |
| Consolidated State Budget deficit (-) /surplus (+), BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | -131.2    | -153.2    | -38.8     | 112.2     | 339.6     | 330.8     | 404.1     | 416.7     | -         |           |           |           | -38.8     | 369.6     |         |
| 2001   | -239.6    | -363.4    | -121.2    | 116.6     | 218.6     | 167.0     | -49.6     | -81.3     | -141.6    | -0.3      | -3.0      | -255.2    | -121.2    | 288.2     | -308.6  |
| Revenues of the Republican Budget, total, BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 521.9     | 985.5     | 1 585.0   | 2 364.3   | 3 042.6   | 3 540.5   | 4 242.3   | 4 783.1   | -         |           |           |           | 1 585.0   | 1 955.5   |         |
| 2001   | 462.5     | 872.5     | 1 550.6   | 2 258.5   | 2 879.4   | 3 358.3   | 3 884.4   | 4 334.9   | 4 764.0   | 5 322.4   | 5 816.6   | 6 525.9   | 1 550.6   | 1 807.7   | 1 405.7 |
| Expenditures of the Republican Budget, total, BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 367.7     | 869.5     | 1 376.1   | 2 113.1   | 2 531.4   | 3 018.5   | 3 718.5   | 4 205.2   | -         |           |           |           | 1 376.1   | 1 642.4   |         |
| 2001   | 832.5     | 1 294.6   | 1 774.1   | 2 356.6   | 2 898.0   | 3 524.7   | 4 332.2   | 4 803.8   | 5 319.5   | 5 732.0   | 6 225.0   | 7 186.0   | 1 774.1   | 1 750.6   | 1 794.8 |
| Republican Budget cash deficit (-) / surplus (+), BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |         |
| 2002   | 154.2     | 116.0     | 208.9     | 251.3     | 511.1     | 521.9     | 523.8     | 577.9     | -         |           |           |           | 208.9     | 313.0     |         |
| 2001   | -370.0    | -422.1    | -223.5    | -98.1     | -18.5     | -166.5    | -447.8    | -468.9    | -555.4    | -409.6    | -408.3    | -660.2    | -223.5    | 57.0      | -388.9  |



# ANNEX 1: MAIN INDICATORS FOR THE THIRD QUARTER OF 2002

| Government and government guaranteed debt                                      |        |        |        |        |        |        |        |        |        |        |        |        | Q3     |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  | I      | II     | III    | IV     | V      | VI     | VII    | VIII   | IX     | X      | XI     | XII    | Q2     |
| Government and government guaranteed debt, BGN million                         |        |        |        |        |        |        |        |        |        |        |        |        | Q3     |
| 2002   | 20 993 | 20 917 | 20 859 | 20 103 | 19 502 | 18 855 | 18 992 | 18 964 | 18 929 |        |        | 20 859 | 18 855 |
| 2001   | 20 486 | 20 458 | 21 058 | 20 612 | 21 610 | 21 797 | 21 198 | 20 367 | 19 846 | 20 041 | 20 709 | 20 752 | 21 797 |
| Domestic government and government guaranteed debt, BGN million                |        |        |        |        |        |        |        |        |        |        |        |        | 19846  |
| 2002   | 1 897  | 1 890  | 1 917  | 1 927  | 1 908  | 1 949  | 1 973  | 1 988  | 2 030  |        |        | 1 917  | 1 949  |
| 2001   | 1 717  | 1 706  | 1 743  | 1 733  | 1 752  | 1 767  | 1 769  | 1 738  | 1 767  | 1 813  | 1 821  | 1 861  | 1 767  |
| Foreign government and government guaranteed debt, BGN million                 |        |        |        |        |        |        |        |        |        |        |        |        | 2030   |
| 2002   | 19 096 | 19 027 | 18 942 | 18 176 | 17 594 | 16 906 | 17 020 | 16 976 | 16 899 |        |        | 18 942 | 16 906 |
| 2001   | 18 769 | 18 752 | 19 315 | 18 879 | 19 859 | 20 029 | 19 429 | 18 629 | 18 080 | 18 228 | 18 888 | 18 892 | 20 029 |
| Government and government guaranteed debt, ratio to the annual GDP, %          |        |        |        |        |        |        |        |        |        |        |        |        | 18080  |
| 2002   | 68.2   | 68     | 67.6   | 65.3   | 63.4   | 61.3   | 61.8   | 61.6   | 61.5   |        |        | 67.8   | 61.3   |
| 2001   | 72.6   | 72.5   | 74.7   | 73.1   | 76.6   | 77.3   | 75.1   | 72.2   | 70.4   | 71     | 73.4   | 73.6   | 77.3   |
| Domestic government and government guaranteed debt, ratio to the annual GDP, % |        |        |        |        |        |        |        |        |        |        |        |        | 61.5   |
| 2002   | 6.2    | 6.1    | 6.2    | 6.3    | 6.2    | 6.3    | 6.4    | 6.5    | 6.6    |        |        | 6.2    | 6.3    |
| 2001   | 6.1    | 6      | 6.2    | 6.2    | 6.2    | 6.3    | 6.3    | 6.2    | 6.3    | 6.4    | 6.5    | 6.6    | 6.3    |
| Foreign government and government guaranteed debt, ratio to the annual GDP, %  |        |        |        |        |        |        |        |        |        |        |        |        | 6.3    |
| 2002   | 62     | 61.8   | 61.4   | 59     | 57.2   | 55     | 55.4   | 55.2   | 54.9   |        |        | 61.5   | 54.9   |
| 2001   | 66.5   | 66.5   | 68.5   | 66.9   | 70.4   | 71     | 68.9   | 66     | 64.1   | 64.6   | 67     | 67     | 71.0   |
| Domestic government debt, total, BGN million                                   |        |        |        |        |        |        |        |        |        |        |        |        | 64.1   |
| 2002   | 1 891  | 1 884  | 1 912  | 1 922  | 1 903  | 1 945  | 1 973  | 1 988  | 2 027  |        |        | 1 912  | 1 945  |
| 2001   | 4 176  | 4 148  | 4 371  | 1 724  | 1 742  | 1 758  | 1 760  | 1 730  | 1 759  | 1 806  | 1 814  | 1 854  | 1 758  |
| Debt on Government Securities issued for budget deficit financing, BGN million |        |        |        |        |        |        |        |        |        |        |        |        | 1759   |
| 2002   | 1 144  | 1 139  | 1 172  | 1 198  | 1 201  | 1 268  | 1 286  | 1 307  | 1 351  |        |        | 1 172  | 1 268  |
| 2001   | 932    | 931    | 946    | 943    | 923    | 941    | 966    | 968    | 997    | 1 042  | 1 042  | 1 077  | 941    |
| Debt on Government Securities issued for structural reform, BGN million        |        |        |        |        |        |        |        |        |        |        |        |        | 1351   |
| 2002   | 746    | 745    | 740    | 724    | 702    | 677    | 684    | 677    | 676    |        |        | 740    | 677    |
| 2001   | 770    | 766    | 796    | 740    | 820    | 816    | 795    | 763    | 763    | 764    | 772    | 777    | 816    |
| Domestic government guarantees, BGN million                                    |        |        |        |        |        |        |        |        |        |        |        |        | 763    |
| 2002   | 6      | 6      | 6      | 5      | 5      | 4      | 4      | 3      | 3      |        |        | 6      | 4      |
| 2001   | 10     | 10     | 10     | 9      | 10     | 9      | 9      | 8      | 7      | 7      | 7      | 10     | 9      |
| Foreign government debt, USD million   |        |        |        |        |        |        |        |        |        |        |        |        | 7      |
| 2002   | 7 925  | 7 921  | 7 921  | 7 840  | 7 936  | 8 103  | 7 997  | 7 996  | 7 967  |        |        | 7 920  | 8 096  |
| 2001   | 8 472  | 8 421  | 8 290  | 8 275  | 8 145  | 8 187  | 8 176  | 8 221  | 7 942  | 7 931  | 8 103  | 8 006  | 8 187  |
| Foreign government guaranteed debt, USD million                                |        |        |        |        |        |        |        |        |        |        |        |        | 7967   |
| 2002   | 508    | 496    | 503    | 505    | 509    | 527    | 524    | 538    | 552    |        |        | 529    | 526    |
| 2001   | 446    | 446    | 433    | 434    | 465    | 497    | 503    | 502    | 499    | 496    | 490    | 507    | 497    |

# ANNEX 1: MAIN INDICATORS FOR THE THIRD QUARTER OF 2002

| Foreign economic relations and foreign investments    |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
|---|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|---------|---------|---------|
|   | I        | II       | III      | IV       | V        | VI       | VII      | VIII     | IX       | X        | XI       | XII      | Q1      | Q2      | Q3      |
| Balance of Payments                                   |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| Current account, USD million                          |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | -131.1   | -49.8    | -54.9    | -137.4   | -100.7   | 98.2     | 119.4    | 153.8    | -28.6    |          |          |          | -235.8  | -139.9  | 244.6   |
| 2001  | -136.4   | -38.6    | -46.1    | -77.8    | -89.7    | -1.6     | -74.8    | 84       | -46      | -114.1   | -155.6   | -145.5   | -221.1  | -169.1  | -36.8   |
| Exports (FOB), USD million                            |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 383.6    | 408.7    | 407.8    | 424.9    | 402.6    | 496.3    | 585.8    | 517.7    | 415.7    |          |          |          | 1 200.1 | 1 323.8 | 1 519.2 |
| 2001  | 397.2    | 429.4    | 455.7    | 412.5    | 391.8    | 429.2    | 454.3    | 447.9    | 424.6    | 454.7    | 451.7    | 363.8    | 1 282.3 | 1 233.5 | 1 326.8 |
| Imports (FOB), USD million                            |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 465.8    | 482.2    | 501.7    | 573.5    | 591.8    | 565.2    | 668      | 580.6    | 575.2    |          |          |          | 1 449.7 | 1 730.5 | 1 823.8 |
| 2001  | 476.8    | 474.6    | 554.5    | 531.2    | 555.9    | 598.9    | 658.5    | 550.6    | 507.1    | 632.6    | 615.3    | 537.4    | 1 505.9 | 1 686.0 | 1 716.2 |
| Trade balance, (FOB), USD million                     |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | -82.2    | -73.5    | -93.9    | -148.7   | -189.2   | -68.9    | -82.2    | -62.9    | -159.5   |          |          |          | -249.6  | -406.8  | -304.6  |
| 2001  | -79.5    | -45.2    | -98.8    | -118.7   | -164.1   | -169.6   | -204.3   | -102.7   | -82.5    | -177.9   | -163.6   | -173.6   | -223.5  | -452.4  | -389.5  |
| Capital account, USD million                          |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        |          |          |          | 0       | 0       | 0       |
| 2001  | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0       | 0       | 0       |
| Financial account, USD million                        |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | -10.7    | 38.5     | 125.7    | 346.5    | 235.2    | 153.6    | 60       | -115.9   | 150.6    |          |          |          | 153.5   | 735.3   | 94.7    |
| 2001  | -49.2    | 35.6     | -184.4   | 182      | 71.2     | 125.5    | 96.9     | -67.9    | 108.9    | 260.3    | 497.1    | -65.3    | -198.0  | 378.7   | 137.9   |
| Direct investment in Bulgaria, USD million            |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 20.1     | 26.8     | 71.1     | 87.4     | 39.5     | -1.6     | 5.6      | 27.1     | 37.6     |          |          |          | 118.0   | 125.3   | 70.3    |
| 2001  | 172.6    | 52.6     | 48.8     | 36.1     | 6.9      | 62.8     | 63.7     | 23.1     | 27.3     | 0        | 84.8     | 115.6    | 274.0   | 105.8   | 114.1   |
| Finance   |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
|   | I        | II       | III      | IV       | V        | VI       | VII      | VIII     | IX       | X        | XI       | XII      | Q1      | Q2      | Q3      |
| Financial indicators                                  |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| Exchange rate BGN / USD, average for the period       |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 2.21474  | 2.24804  | 2.23369  | 2.20959  | 2.13121  | 2.04781  | 1.97152  | 2.00039  | 1.99537  | 1.99354  |          |          | 2.23216 | 2.12954 | 1.98909 |
| 2001  | 2.08480  | 2.12230  | 2.15127  | 2.19193  | 2.23394  | 2.29254  | 2.27299  | 2.17258  | 2.14128  | 2.15933  | 2.20198  | 2.19164  | 2.11946 | 2.23947 | 2.19562 |
| Exchange rate BGN / USD, end of the period            |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 2.26448  | 2.26081  | 2.24190  | 2.17121  | 2.08355  | 1.96073  | 1.99921  | 1.98905  | 1.98360  | 1.9828   |          |          | 2.24190 | 1.96073 | 1.98360 |
| 2001  | 2.10463  | 2.11487  | 2.21448  | 2.16761  | 2.30640  | 2.30640  | 2.23396  | 2.13565  | 2.14197  | 2.16305  | 2.19806  | 2.21926  | 2.21448 | 2.30640 | 2.14197 |
| Basic interest rate, effective annual, for the period |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 4.86     | 4.66     | 4.52     | 4.16     | 3.98     | 3.79     | 3.72     | 3.82     | 3.81     | 3.76     |          |          | 4.52    | 3.79    | 3.81    |
| 2001  | 4.49     | 4.17     | 4.23     | 4.35     | 4.5      | 4.55     | 4.58     | 4.76     | 4.81     | 4.72     | 4.77     | 4.75     | 4.23    | 4.55    | 4.81    |
| Money (M1), BGN million                               |          |          |          |          |          |          |          |          |          |          |          |          |         |         |         |
| 2002  | 4 651.40 | 4 584.30 | 4 594.20 | 4 602.90 | 4 474.80 | 4 402.90 | 4 589.00 | 4 750.40 | 4 804.90 |          |          |          | 4594.20 | 4402.90 | 4804.90 |
| 2001  | 3 962.30 | 3 978.90 | 4 010.90 | 4 128.20 | 4 135.70 | 4 039.20 | 4 163.90 | 4 193.70 | 4 275.10 | 4 240.90 | 4 982.00 | 4 883.80 | 4010.90 | 4039.20 | 4275.10 |

# ANNEX 1: MAIN INDICATORS FOR THE THIRD QUARTER OF 2002

| Money (M2), BGN million   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| 2002  | 12 035.30 | 12 068.50 | 12 088.10 | 12 136.00 | 11 902.60 | 11 875.70 | 12 243.50 | 12 521.50 | 12 589.70 |           | 12 088.10 | 11 875.70 | 12 589.70 | 12 589.70 |           |
| 2001  | 9 776.10  | 9 863.90  | 9 977.40  | 9 662.00  | 9 934.70  | 10 208.20 | 10 548.80 | 10 682.90 | 10 887.30 | 10 941.10 | 11 167.00 | 12 100.80 | 10 208.20 | 10 887.30 |           |
| International reserves of BNB, BGN million  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 7 372.40  | 7 373.00  | 7 196.20  | 7 427.80  | 7 546.30  | 7 908.40  | 8 034.30  | 8 231.80  | 8 496.20  |           | 7 196.20  | 7 908.40  | 8 496.20  | 8 496.20  |           |
| 2001  | 6 889.50  | 6 820.30  | 6 820.00  | 6 862.60  | 6 939.20  | 7 010.70  | 6 802.70  | 6 687.80  | 6 683.40  | 6 986.50  | 7 701.40  | 7 943.00  | 7 010.70  | 6 683.40  |           |
| Fiscal reserves at the Issue Department of BNB, BGN million   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 2 276.2   | 2 260.4   | 2 106.5   | 2 358.9   | 2 803.3   | 3 020.8   | 3 065.5   | 3 108.2   | 3 238.9   | 3 482.0   |           | 2 106.46  | 3 020.76  | 3 238.89  |           |
| 2001  | 2 388.9   | 2 260.4   | 2 329.1   | 2 878.9   | 2 863.9   | 2 925.3   | 2 418.6   | 2 304.3   | 2 129.4   | 2 440.4   | 2 913.2   | 2 571.2   | 2 925.29  | 2 129.43  |           |
| Banking system  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
|   | I         | II        | III       | IV        | V         | VI        | VII       | VIII      | IX        | X         | XI        | XII       | Q1        | Q2        | Q3        |
| Credits granted to non-financial institutions and other customers, total, end of the period, BGN thousand |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 4 226 013 | 4 267 336 | 4 354 165 | 4 527 779 | 4 651 472 | 4 769 243 | 5 047 813 | 5 179 755 | 5 414 813 |           |           |           | 4 354 165 | 4 769 243 | 5 414 813 |
| 2001  | 3 040 998 | 3 037 279 | 3 169 673 | 3 285 333 | 3 383 689 | 3 426 012 | 3 519 280 | 3 601 196 | 3 808 035 | 3 994 028 | 4 143 907 | 4 145 865 | 3 169 673 | 3 426 012 | 3 808 035 |
| Credits granted to the budget, end of the period, BGN thousand  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 5 505     | 6 739     | 7 291     | 7 031     | 7 314     | 6 871     | 6 564     | 9 494     | 9 601     |           |           |           | 7 291     | 6 871     | 9 601     |
| 2001  | 3 396     | 5 199     | 5 870     | 5 042     | 4 707     | 4 023     | 4 195     | 4 648     | 91 972    | 145 710   | 149 712   | 5 772     | 5 870     | 4 023     | 91 972    |
| Credits granted to state owned companies, end of the period, BGN thousand                                 |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 164 898   | 156 145   | 161 650   | 201 201   | 203 441   | 193 604   | 193 793   | 195 258   | 183 275   |           |           |           | 161 650   | 193 604   | 183 275   |
| 2001  | 111 436   | 118 284   | 122 139   | 121 285   | 122 095   | 130 020   | 140 881   | 128 437   | 121 422   | 120 827   | 117 572   | 148 273   | 122 139   | 130 020   | 121 422   |
| Credits granted to private companies, end of the period, BGN thousand                                     |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 3 220 930 | 3 255 827 | 3 312 957 | 3 409 601 | 3 508 806 | 3 601 207 | 3 838 302 | 3 923 562 | 4 125 524 |           |           |           | 3 312 957 | 3 601 207 | 4 125 524 |
| 2001  | 2 360 768 | 2 343 920 | 2 434 243 | 2 518 381 | 2 582 162 | 2 586 954 | 2 640 167 | 2 709 482 | 2 818 212 | 2 926 183 | 3 055 534 | 3 159 490 | 2 434 243 | 2 586 954 | 2 818 212 |
| Credits granted to individuals and households, end of the period, BGN thousand                            |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 834 680   | 848 625   | 872 267   | 909 946   | 931 911   | 967 561   | 1 009 154 | 1 051 441 | 1 096 413 |           |           |           | 872 267   | 967 561   | 1 096 413 |
| 2001  | 565 398   | 569 876   | 607 421   | 640 625   | 674 725   | 705 015   | 734 037   | 758 629   | 776 429   | 801 308   | 821 089   | 832 330   | 607 421   | 705 015   | 776 429   |
| Credits granted to the budget, % of the total   |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 0.13      | 0.16      | 0.17      | 0.16      | 0.16      | 0.14      | 0.13      | 0.18      | 0.18      |           |           |           | 0.17      | 0.14      | 0.18      |
| 2001  | 0.11      | 0.17      | 0.19      | 0.15      | 0.14      | 0.12      | 0.12      | 0.13      | 2.42      | 3.65      | 3.61      | 0.14      | 0.19      | 0.12      | 2.42      |
| Credits granted to state owned companies, % of the total  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 3.90      | 3.66      | 3.71      | 4.44      | 4.37      | 4.06      | 3.84      | 3.77      | 3.38      |           |           |           | 3.71      | 4.06      | 3.38      |
| 2001  | 3.66      | 3.89      | 3.85      | 3.69      | 3.61      | 3.80      | 4.00      | 3.57      | 3.19      | 3.03      | 2.84      | 3.58      | 3.85      | 3.80      | 3.19      |
| Credits granted to private companies, % of the total  |           |           |           |           |           |           |           |           |           |           |           |           |           |           |           |
| 2002  | 76.22     | 76.30     | 76.09     | 75.30     | 75.43     | 75.51     | 76.04     | 75.75     | 76.19     |           |           |           | 76.09     | 75.51     | 76.19     |
| 2001  | 77.63     | 77.17     | 76.80     | 76.66     | 76.31     | 75.51     | 75.02     | 75.24     | 74.01     | 73.26     | 73.74     | 76.21     | 76.80     | 75.51     | 74.01     |

ANNEX 1: MAIN INDICATORS  
FOR THE THIRD QUARTER OF 2002

| Credits granted to individuals and households, % of the total   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|---|------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|----------|
|   | 2002 | 19.75      | 19.89      | 20.03      | 20.10      | 20.03      | 20.29      | 19.99      | 20.30      | 20.25      |            | 20.03      | 20.29      | 20.25    |
|   | 2001 | 18.59      | 18.76      | 19.16      | 19.50      | 19.94      | 20.58      | 20.86      | 21.07      | 20.39      |            | 19.81      | 20.08      | 20.58    |
| Total assets, end of the period, BGN thousand   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 12 340 044 | 12 286 166 | 12 710 381 | 12 722 090 | 12 473 976 | 12 394 798 | 12 924 968 | 13 225 015 | 13 475 455 |            | 12710381   | 12394798   | 13475455 |
|   | 2001 | 10 030 490 | 10 009 095 | 10 793 278 | 10 421 043 | 10 951 545 | 11 103 981 | 11 156 644 | 11 199 882 | 11 440 501 | 11 411 506 | 11 545 701 | 12 220 529 | 11103981 |
| Total liabilities , end of the period, BGN thousand   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 10 676 646 | 10 602 225 | 11 014 662 | 11 040 181 | 10 782 330 | 10 682 602 | 11 197 870 | 11 455 975 | 11 681 572 |            | 11014662   | 10682602   | 11681572 |
|   | 2001 | 8 510 363  | 8 470 980  | 9 143 456  | 8 731 672  | 9 462 114  | 9 609 537  | 9 623 763  | 9 640 825  | 9 878 415  | 9 819 659  | 9 937 092  | 10 565 823 | 9609537  |
| Interest revenues, BGN thousand   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 56 711     | 110 773    | 168 685    | 224 465    | 283 518    | 342 850    | 405 735    | 468 644    | 533 137    |            | 168685     | 342850     | 533137   |
|   | 2001 | 55 742     | 107 205    | 163 567    | 220 524    | 279 833    | 336 002    | 395 993    | 453 631    | 509 521    | 568 718    | 625 241    | 686 760    | 336002   |
| Current profit/loss, BGN thousand   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 25 913     | 47 270     | 56 996     | 80 116     | 112 082    | 132 715    | 148 229    | 182 185    | 201 740    |            | 56996      | 132715     | 201740   |
|   | 2001 | 25 980     | 43 663     | 157 588    | 183 083    | 197 758    | 203 302    | 229 939    | 255 411    | 274 876    | 292 643    | 309 412    | 319 375    | 203302   |
| Social policy and industrial relations  |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   |      | I          | II         | III        | IV         | V          | VI         | VII        | VIII       | IX         | X          | XI         | XII        | Q1       |
| Wage&Salary   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
| Average Monthly Wage&Salary of employees under labor contract, total, nominal, BGN  |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 251        | 252        | 265        | 262        | 269        | 265        | 267        | 265        | 272        |            | 256        | 265        | 268      |
|   | 2001 | 231        | 228        | 239        | 248        | 254        | 254        | 249        | 248        | 256        | 253        | 255        | 270        | 252      |
| Average Monthly Wage&Salary of employees under labor contract, public sector, nominal, BGN  |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 282        | 285        | 304        | 298        | 318        | 311        | 309        | 312        | 328        |            | 290        | 309        | 316      |
|   | 2001 | 257        | 254        | 271        | 281        | 300        | 295        | 287        | 284        | 307        | 287        | 293        | 316        | 292      |
| Average Monthly Wage&Salary of employees under labor contract, private sector, nominal, BGN   |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 229        | 229        | 238        | 238        | 236        | 235        | 240        | 236        | 237        |            | 232        | 236        | 238      |
|   | 2001 | 211        | 208        | 214        | 223        | 222        | 225        | 222        | 224        | 221        | 230        | 229        | 238        | 222      |
| Real Average Monthly Wage&Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %          |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 1.6        | 2.0        | 1.6        | -3.3       | -0.9       | -0.8       | 1.6        | 2.3        | 2.2        |            | 1.7        | -1.7       | 2.0      |
|   | 2001 | 6.2        | 3.5        | 1.2        | 3.6        | 2.9        | 4.1        | 2.9        | 5.7        | 4.1        | 7.4        | 4.2        | 4.7        | 3.5      |
| Real Average Monthly Wage&Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %  |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 2.6        | 3.5        | 2.8        | -2.9       | -0.8       | 0.2        | 2.1        | 5.2        | 2.8        |            | 3.0        | -1.2       | 3.3      |
|   | 2001 | 6.4        | 5.5        | 2.4        | 4.9        | 6.0        | 7.5        | 6.7        | 8.8        | 7.8        | 10.0       | 5.3        | 5.8        | 6.1      |
| Real Average Monthly Wage&Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, % |      |            |            |            |            |            |            |            |            |            |            |            |            |          |
|   | 2002 | 1.4        | 1.6        | 1.9        | -2.3       | -0.6       | -0.7       | 2.5        | 0.8        | 3.1        |            | 1.6        | -1.2       | 2.2      |
|   | 2001 | 7.8        | 3.6        | 2.4        | 4.1        | 3.2        | 3.4        | 1.3        | 4.9        | 3.0        | 6.1        | 4.7        | 5.6        | 3.1      |

Sources: Employment Agency, Bulgarian national bank, Ministry of finance, National statistical institute and own calculations.

“-“ = Not applicable or missing data



## ANNEX 2: NEWLY PASSED LEGISLATION PROMULGATED IN THE THIRD QUARTER OF 2002

### NEWLY PASSED LEGISLATION PROMULGATED IN THE THIRD QUARTER OF 2002

| Title   | Status  | Official Gazette  |
|---|---------|---|
| REGULATION on the Raising, Spending, and Control of Assets in Environment Protection Funds  | Amended | No. 64 of 2 July 2002                                   |
| ACT on the Ratification of the 2001 Annual Financial Agreement between the European Commission on the part of the European Community and the Republic of Bulgaria under the SAPARD Program (Special Accession Program for Agricultural and Rural Development in the Republic of Bulgaria) | New     | No. 66 of 9 July 2002                                   |
| REGULATION on the Procedure of Import and Export of Hazardous Chemical Substances, Preparations, and Products into and from the Territory of the Republic of Bulgaria   | New     | No. 66 of 9 July 2002                                   |
| Patent ACT  | Amended | No. 66 of 9 July 2002                                   |
| RULES on the Implementation of the Child Benefits ACT   | New     | No. 67 of 12 July 2002                                  |
| REGULATION No. 13 / 2 July 2002 on Defining Telecommunication Activities Subject to Individual Licensing, General License Registration, and Free Regime   | New     | No. 67 of 12 July 2002                                  |
| PROTOCOL on Bulgaria's Accession to the Marrakech Treaty on the Establishment of the World Trade Organization   | New     | No. 67 of 12 July 2002                                  |
| REGULATION on the Formation of the Wage Fund in Commercial Companies with over 50 Per Cent State or Municipal Interest in 2002  | Amended | No. 67 of 12 July 2002                                  |
| REGULATION on the Terms and Procedure of Operation of the Central Register of Compensatory Instruments  | New     | No. 71 of 23 July 2002                                  |
| REGULATION on the Activities of the Central Depository on Registration of the Issuance of and Transactions in Compensatory Instruments, and on Making Payment by Compensatory Instruments   | New     | No. 71 of 23 July 2002                                  |
| DECISION No. 485/15 July 2002 on the Approval of an Annual List of Commercial Companies with State Interest in their Capital, for which Privatization against Payment by Non-cash Instruments is Allowed for the Year 2002  | New     | No. 71 of 23 July 2002                                  |
| ACT on the Ratification of the Kyoto Protocol to the UN Framework Convention on Climate Fluctuation   | New     | No. 72 of 25 July 2002                                  |
| DECREE No. 265 on Referring Back the Bio-diversity Act and the Reasons to the Decree  | New     | No. 72 of 25 July 2002                                  |
| Punitive CONVENTION on Corruption   | New     | No. 73 of 26 July 2002                                  |
| Mandatory Social Security CODE  | Amended | No. 74 of 30 July 2002                                  |
| Waters ACT  | Amended | No. 74 of 30 July 2002                                  |
| Judicial System ACT   | Amended | No. 74 of 30 July 2002                                  |
| REGULATION on the Formation and Application of Electricity Rates and Tariffs  | Amended | No. 74 of 30 July 2002                                  |
| REGULATION on the Formation and Application of Thermal Energy Rates and Tariffs   | Amended | No. 74 of 30 July 2002                                  |
| REGULATION on the Formation and Application of Natural Gas Rates and Tariffs  | Amended | No. 74 of 30 July 2002                                  |
| REGULATION on the Granting and Payment of Unemployment Benefits   | Amended | No. 74 of 30 July 2002                                  |
| ACT on the Structure of the State Budget  | Amended | No. 74 of 30 July 2002                                  |
| Criminal Procedure CODE   | Amended | No. 74 of 30 July 2002                                  |
| ACT on the 2002 State Social Security Budget  | Amended | No. 74 of 30 July 2002                                  |
| ACT on the Publicity of the Property of Persons Holding Senior Government Offices   | Amended | No. 74 of 30 July 2002                                  |
| DECREE No. 159/23 July 2002 of CoM on Structural Changes in the Healthcare System   | New     | No. 74 of 30 July 2002                                  |
| REGULATION No. 3 on Wire Settlements and the National System of Settlement  | New     | No. 75 of 2 August 2002 and No. 92 of 27 September 2002 |

## ANNEX 2: NEWLY PASSED LEGISLATION PROMULGATED IN THE THIRD QUARTER OF 2002

|  |         |  |
|--|---------|--|
| DECREE No. 163/24 July 2002 of CoM on the Approval of the Privatization Agency Rules of Procedure  | New     | No. 75 of 2 August 2002                                    |
| Pensions REGULATION  | Amended | No. 76 of 6 August 2002                                    |
| DECREE No. 276 on Referring Back to the National Assembly the Environment Protection Act and the Reasons to the Decree   | New     | No. 76 of 6 August 2002                                    |
| Bio-diversity ACT  | New     | No. 77 of 9 August 2002                                    |
| DECREE No. 287 on Referring Back to the National Assembly the Act Constituting an Amendment to the Banking Act and the Reasons to the Decree   | New     | No. 77 of 9 August 2002                                    |
| Protected Territories ACT  | Amended | No. 77 of 9 August 2002                                    |
| Forestry ACT   | Amended | No. 77 of 9 August 2002                                    |
| REGULATION No. 6 on the Procedure of Monitoring and Ensuring Transparency of State Aid   | New     | No. 77 of 9 August 2002                                    |
| Privatization and Post-privatization Control ACT   | Amended | No. 78 of 13 August 2002                                   |
| REGULATION No. 8/1997 on the Capital Adequacy of Banks   | Amended | No. 79 of 16 August 2002                                   |
| REGULATION on the Classification Rules for Vinous Vine Varieties   | New     | No. 80 of 20 August 2002                                   |
| REGULATION on the Terms and Procedure of Planting New Vineyards, Replanting, Engrafting and Uprooting of Existing Vineyards  | New     | No. 80 of 20 August 2002                                   |
| RULES on the Implementation of the Social Assistance Act   | Amended | No. 81 of 23 August 2002                                   |
| INSTRUCTION No. 13/31 October 2000 on the Implementation of the REGULATION on the Categorization of Labor at Retirement  | Amended | No. 84 of 3 September 2002                                 |
| DECREE No.33/11 February 2002 of CoM on the Organization and Coordination of Bulgaria's Preparation for Accession to the European Union and on Holding the Negotiations for Accession  | Amended | No. 85 of 5 September 2002 and No. 86 of 10 September 2002 |
| DECREE No. 233/8 November 2000 of CoM on the Foreign Trade Regime of the Republic of Bulgaria  | Amended | No. 87 of 10 September 2002                                |
| REGULATION on the Mandatory Information to be Provided to Persons Who Have Stated Their Interest to Participate in Privatization under the Privatization and Post-Privatization Control Act, and on the Documents and Information Representing Official Secret | New     | No. 87 of 13 September 2002                                |
| REGULATION on the Terms and Procedure for Organization of Centralized Public Auctions for Sale of State-Held Shares  | New     | No. 89 of 20 September 2002                                |
| ACT on the Ratification of the Dealer Managers Agreement between the Republic of Bulgaria and J P Morgan Securities Inc., J P Morgan Europe Limited, and Salomon Smith Barney Inc.   | New     | No. 89 of 20 September 2002                                |
| Environment Protection ACT   | New     | No. 91 of 25 September 2002                                |
| Banking ACT  | Amended | No. 91 of 25 September 2002                                |
| Atmospheric Air Cleanness ACT  | Amended | No. 91 of 25 September 2002                                |
| Protected Territories ACT  | Amended | No. 91 of 25 September 2002                                |
| Waters ACT   | Amended | No. 91 of 25 September 2002                                |
| ACT on the Transformation of the State Savings Bank  | Amended | No. 91 of 25 September 2002                                |
| Independent Fiscal Audit ACT   | Amended | No. 91 of 25 September 2002                                |

ANNEX 2: NEWLY PASSED LEGISLATION  
PROMULGATED IN THE THIRD QUARTER OF 2002

|                             |         |                             |
|-----------------------------|---------|-----------------------------|
| Accountancy ACT             | Amended | No. 91 of 25 September 2002 |
| Medicinal Plants ACT        | Amended | No. 91 of 25 September 2002 |
| Bank Bankruptcy ACT         | New     | No. 92 of 27 September 2002 |
| Banking ACT                 | Amended | No. 92 of 27 September 2002 |
| Bank Deposits Guarantee ACT | Amended | No. 92 of 27 September 2002 |

## A. THE REVIEW OF BULGARIAN ECONOMY

The present review of Bulgarian economy is an authentic expert product of the Center for Economic Development, which was made possible mostly owing to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.

The review of Bulgarian economy in the third quarter of 2002 contains detailed presentation of this last period, assessment of the period and subsequent trends. The review is explicitly focused on this quarter of the current year. Where necessary, significant events, facts and data of periods prior to or after the end of the quarter have been highlighted. Where possible three main types of data comparisons have been made: against the respective period of 2001, against the end of 2001, or against the end of the second quarter of the year. Again where possible, the dynamics within the quarter itself has been traced, too. At many points also the short-term trend has been outlined.

The structure of the presentation above follows two principles simultaneously. First, the strive is towards giving a more comprehensive presentation of the subject matter areas, with prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience and interests of the experts and of the Center for Economic Development as a whole.

The review of Bulgaria's economy in the third quarter of the year 2002 starts with presentation of the findings of the business climate survey. The latest values of the Estat index of business climate in Bulgaria are presented. On the basis of the results of the survey an analysis is made of the condition and prospects of the business environment in our country. The business surveys conducted by the NSI are presented immediately after that.

The overall dynamics of the economy in the third quarter of 2002 has been discussed against the

background of the following basic categories: GDP, industry, inflation, and labor market. The fiscal review of the quarter starts with a presentation of the budget implementation. The fiscal review covers also the topics on taxes, customs duties, foreign debt and domestic debt. The privatization topic is followed by discussion on small and medium-sized enterprises. The foreign economic relations followed by foreign investments are presented in statistical terms, and in their thematic relation, by means of data about the balance of payments and foreign trade. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria - energy, transport, high technology, communications, tourism and agriculture. The financial sector is discussed by means of the capital market and the banking system. The wide topic of social policy and industrial relations encompasses the matters of social security, employment and unemployment, income and living standards, and social partnership. The current problems of the healthcare reform are discussed briefly. The environmental policy is considered simultaneously as a specific component of the economic policy, factor for the economic environment and an indicator of certain trends in the development. The specialized analysis of the process of Bulgaria's accession with the EU is underpinned by the understanding that in the course of these negotiations often the most determinative components of economic policy are defined. There exists also a two-way interdependence between the competitiveness of the Bulgarian economy at macro- and company level, and the status of the negotiations. That is why in the context of the review and general analysis of the Bulgarian economy in the third quarter the choice was made to lay down the emphasis on the negotiations for EU membership as the most significant aspect of the European integration process, which encompasses the adaptation and application of *acquis*.

An integral part of the presentation are the two appendices: the detailed table showing basic indices of the quarter (Appendix 1) and the list of newly passed legislation and amendments to laws, which are of

significant importance to the economic development of the country, and were promulgated in the Official Gazette during the third quarter of the year (Appendix 2).

This work was finally completed on 5th December 2002.

## B. SOURCES

Alongside with the conclusions from the large number of their own outputs and works, some of which are parts of concrete research projects, the experts of the Center for Economic Development have used statistical and other input information and data from the following sources:

- National Assembly
- Council of Ministers
- Ministry of Agriculture and Forestry
- Ministry of Finance
- Ministry of Economy
- Ministry of Regional Development and Public Works
- Ministry of Transport and Communications
- Ministry of Labor and Social Policy
- Ministry of Environment and Water
- Bulgarian National Bank
- Bulgarian Stock Exchange - Sofia AD
- National Statistics Institute
- National Social Security Institute
- Employment Agency
- Agency for Small and Medium-sized Enterprises
- Privatization Agency
- State Insurance Supervision Agency
- State Energy Regulation Commission
- Delegation of the European Commission
- European Union
- International Petroleum Exchange
- EUROSTAT
- Official Gazette

The particular sources and publications are quoted at the respective places in the text.

## C. THE ESTAT INDEX OF BUSINESS CLIMATE IN BULGARIA

The business climate survey is based on own original methodology, developed by a team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. The more significant details are described below.

### *Methodology of the Sample*

The survey was conducted among 395 companies. The sample is a two-level panel one (at the first level the companies are divided into groups by regions, and at the second level - according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices "number of employees" and "type of ownership". The sample is a guaranteed representative one at the level of going concerns.

### *Methodology of the Registration*

The information has been collected using the method of an inquiry at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign financial statement documents (managers, chief accountants, commercial or marketing directors).

The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three components. The questions from one to five include comprise Component I - "General Condition of the Company"; question six - Component II - "Investment Attitudes and Corporate Strategies"; questions seven and eight - Component III - "Business Environment".

### *General Description of the Index Calculation*

#### 1. Preliminary preparation



The preliminary preparation includes weighting of data according to the indices “economic sector” and “number of employees”, recoding and calculating values for the respective questions:

- Questions with one possible answer

The original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done in such a way that the scale to be from -2 (the lowest degree) to +2 (the highest degree).

- Multiple choice questions

These questions are recoded in advance in such a way that the possible answers are located symmetrically on both sides of the neutral point (the zero).

## 2. Calculation of the components

The index for each question (indicator) is calculated as a weighted average value.

Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investment Attitudes and Corporate Strategies”; “Business Environment”) is calculated as a weighted average.

The first table above shows the values obtained for the three components and the integrated index.

## 3. Calculation of an integrated index

The integrated index is calculated as a weighted average of the three components. The weight for each of the components is determined by means of expert evaluation.

The Estat index of business climate assumes values from -100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate

Index:

|             |           |
|-------------|-----------|
| -100 to -61 | very poor |
| -61 to -21  | poor      |
| -20 to +20  | average   |
| +21 to +60  | good      |
| +61 to +100 | very good |

Interpretation

All components (with no exception), as well as the integrated index assume values within the interval [-100, +100]. The set of tools allows to determine also the direction of the index. The difference between the values of questions Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain point in time) and Q1 (assessment of the condition during the preceding period) is applied as a criterion for determining the direction.

**Beside everything aforesaid about the methodology, in many cases throughout the text additional methodological and other notes and comments are given.**

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